REPORT

TO THE

SAN FRANCISCO BOARD OF SUPERVISORS

REVIEW

OF THE

INVESTMENT POLICIES, PROCEDURES AND PRACTICES OF THE

TREASURER'S OFFICE

BUDGET ANALYST
FOR THE
SAN FRANCISCO BOARD OF SUPERVISORS

October, 1984

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CITY AND COUNTY OF SAN FRANCISCO

BOARD OF SUPERVISORS

BUDGET ANALYST

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October 18, 1984

Honorable Quentin L. Kopp
Member, Board of Supervisors
Room 235, City Hall
San Francisco, California 94102

Dear Supervisor Kopp:

Transmitted herewith is the Budget Analyst's report on the review of the investment policies, procedures and practices of the Treasurer's Office. In directing us to conduct this management audit, the Board of Supervisors was mindful of the recent problems of the City of San Jose.

Currently the City's investment portfolio is just over $1.0 billion. The Treasurer has invested the City's idle funds in instruments that are sound and return interest earnings which are significantly greater than those earned by the State's investment pool. The Treasurer has made significant improvements in the operations of her Investment Division. Certain internal control and investment policy guidelines have been instituted. Computerized investment and cash flow analysis and information systems have been developed and installed. The Division recently began using a small personal computer to analyze investment information. The Division uses Moneymax and Tellerate investment information services.

However, our review has disclosed several areas which we believe should be strengthened in order to improve the operations of the Treasurer's Office. Our findings are as follows:

- In 1972, the Board of Supervisors, through Administrative Code Section 10.79-2, delegated its authority to invest the City's idle funds to the Treasurer. However, the City's investment policies are established by the Treasurer without obtaining approval from the Board of Supervisors. The Treasurer does not report to the Board on investment transactions as stated in the City's Administrative Code. This results in a lack of information provided to the Board for the purpose of reviewing the investment policies and activities of the Treasurer.

- The City's Chief Investment Officer (CIO) alone determines the amount and number of each type of investment to purchase based on the investment's yield, liquidity, maturity, and risk. While the transactions of the Treasurer are audited for legality and conformance to generally accepted accounting practices, the portfolio is not independently analyzed for performance, yield, mix of securities, average maturity, or strategy. As a result, there is effectively no outside, independent oversight of the investments made by the Treasurer. The Board of Supervisors should receive an annual portfolio analysis report from an outside, independent firm experienced in investments not only because such an independent analysis of all City functions is necessary but also because the Board needs such information to review the investment policies and activities of the Treasurer.

- As of September 14, 1984, the City had investments totalling $349.3 million (nearly 34% of its portfolio) which on average will not mature for over eight years or in 1993. Some investment analysts believe that cities should not invest in such long term investments because cities may be required to sell these investments before maturity at a loss in order to meet unexpected cash requirements to pay the City's bills. On the other hand, there are some analysts who believe that surplus funds only, in contrast to total idle funds, should be invested in long term securities. Still other analysts believe that once cash requirements have been met, then long term investments are appropriate.

- As of September 14, 1984, the market value of the total portfolio was approximately $34 million or 3.4 percent below its cost. The problem with a portfolio that is valued below its cost is a) if the portfolio had to be liquidated, the loss would be real; b) there are opportunity losses because the money in the portfolio cannot be invested in other higher paying investments without taking a loss; and c) the investor can try to make up for the "paper losses" by buying more securities, hoping that the market will improve (which is what happened to the City of San Jose). However, it should be noted that the City can readily meet its cash requirements at this time. Therefore, the portfolio does not have to be liquidated. Further, if interest rates were to decline, the value of the portfolio could increase significantly.

- The information available for cash flow analysis is presently inadequate. As a result, the Treasurer's staff cannot always properly select investment instruments which would result in the best rate of return for the City's portfolio. Additional information for cash flow analysis would improve the timing of portfolio investments resulting in estimated increased interest earnings of $110,000 annually.

- While the Chief Investment Officer (CIO) regularly consults with the Treasurer, the CIO is the only employee in the Treasurer's Office who has been thoroughly trained in investing and managing the City's portfolio. Operating by himself, without trained assistance, results in all of the City's day-to-day investment decisions being made by one person. Prior to his vacations and other known absences, the CIO times investments in order that only those investments needed to meet cash requirements will mature during his absence. This sometimes results in investments which do not yield the highest interest income.

- The personnel in the Investment Division of the Treasurer's Office work in an area that often has a very high temperature. As a result, working conditions are inadequate and could result in equipment failure and personnel illness. Additionally, there is inadequate space and electrical service for the Investment Division.

We have made the following recommendations pertaining to the above-cited findings:

- We recommend that the Board of Supervisors amend the City's Administrative Code to require that the Treasurer, in addition to submitting a monthly report of all investment transactions to the Board of Supervisors, also be required to provide additional monthly information on the details of investment transactions, to provide an annual investment policy to the Board of Supervisors for approval and to transmit the approved City investment policy to appropriate banks, savings and loan associations, dealers and brokers in order to advise these financial institutions of the City's restrictions on investments.

- We recommend that the Board of Supervisors annually contract with a firm experienced in investments for a portfolio analysis of the investments made by the Treasurer.

- We recommend that the Treasurer instruct all City Departments to provide monthly reports projecting their cash requirements so that the Treasurer can establish an improved system to analyze cash flow.

- We recommend that the Cash Manager receive training in investment analysis and decision making and that the Treasurer should request the Civil Service Commission to reclassify the Cash Manager position to an Assistant Investment Officer/Cash Manager position.

- We recommend that a unit air conditioner be installed in the Investment Division's workspace and that increased space and improved electrical service be provided for this division.

We estimate that the implementation of these recommendations would result in estimated increased interest income of at least $110,000 annually. Additional annual interest income in an amount which cannot be fairly estimated might also result from the implementation of our recommendations. The estimated cost to implement these recommendations is $20,000 annually plus a one time cost of $15,000. However, even more important than the increased revenues which would accrue to the City under our recommendations, the Board of Supervisors would receive essential information about the policies, procedures, practices and results of the City's investments which the Board is not now receiving. This information should increase the likelihood of preventing investment losses.

The Treasurer has had the opportunity to review and comment on this report. Her written response is attached to this report on page 22. Throughout the course of this management audit, we received full cooperation from the Treasurer and her staff as well as the staffs of other City Departments.

Respectfully submitted,

Harvey M. Rose
Budget Analyst

cc: President Nelder
Supervisor Britt
Supervisor Hongisto
Supervisor Kennedy
Supervisor Maher
Supervisor Molinari
Supervisor Renne
Supervisor Silver
Supervisor Walker
Supervisor Ward
Clerk of the Board
Mary Callanan
Dan Daly
Mayor Feinstein
James Lazarus
John Farrell
Mark Kertz

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INTRODUCTION

This management audit by the Budget Analyst has been conducted at the request of the Board of Supervisors. The Board, in requesting the audit, was mindful of the recent problems of the City of San Jose. The primary focus of this management audit was to review investment policies, procedures and practices of the Treasurer of the City and County of San Francisco.

According to published reports, the City of San Jose lost approximately $60 million from costs associated with investments having an average maturity of seventeen years. San Jose's investors intended to make a profit for the city by purchasing long term investments and selling them after their market prices had risen. However, the market prices of the purchased investments fell. While these losses were reported, the reports were apparently ignored or not clear, or both. The City could have limited its losses significantly if further purchases of long term securities were stopped. However, after these losses, the City's investors continued to purchase long-term investments, again anticipating that the market price of the purchased investments would rise and could be sold at a profit. In addition, funds were borrowed through a technique called reverse repurchase agreements. The borrowed funds were then used to purchase additional long-term investments. The use of reverse repurchase agreement borrowings significantly increased the investment amounts which San Jose had at risk, particularly because the collateral pledged to the reverse repurchase agreements were the long term investments which were losing market value. In May, 1984, the City of San Jose did not have cash available to pay the reverse repurchase agreement loans coming due. In order to obtain sufficient cash to pay the reverse repurchase agreement loans, San Jose sold its long-term investments and other securities at a loss. The total losses from these transactions totalled approximately $60 million. All of the investments involved with San Jose's loss were permissible under State and San Jose City law. The investment strategy which allowed the excessive use of reverse repurchase agreements to borrow funds to purchase additional long term investments was the most important factor causing San Jose's high investment losses. The Treasurer of the City and County of San Francisco has, as a matter of practice, chosen not to use reverse repurchase agreements.

Our approach to this management audit consisted of conducting extensive interviews with employees from the offices of the Treasurer, the Controller, the City Attorney, the Health, and the Public Works departments. We reviewed the laws, documents and procedures involved with the investing of City funds. In addition, we conducted interviews with personnel from the Cities of Sacramento and Monterey, Contra Costa County, Bank of America (the City's depository), Lehman Commercial Paper (investment dealers) and Peat, Marwick, Mitchell (the City's outside auditors).

The Treasurer has invested the City's idle funds in instruments that are sound and return interest earnings which are significantly greater than those earned by the State's investment pool. The Treasurer has made significant improvements in the operations of her Investment Division. Certain internal control and investment policy guidelines have been instituted. Computerized investment and cash flow analysis and information systems have been developed and installed. The Division recently began using a small personal computer to analyze investment information. The Division uses Moneymax and Tellerate investment information services.

The Board of Supervisors authorized a 1984-85 budget of $225,767 and four positions for the Investment Division of the Treasurer's Department. The Investment Division's personnel include a Chief Investment Officer, Cash Manager, Senior Account Clerk and Clerk Typist. The Cash Manager was hired in August of this year.

While the value of the City's investment portfolio varies by millions of dollars, currently it is just over $1.0 billion dollars. The investments in this portfolio are purchased with idle monies from various funds which are not needed for the immediate payment of the City's bills. The funds contributing to the portfolio on August 31, 1984 were as follows (also see Chart A immediately following this introduction):

Fund Group	Amount (Rounded)	Percentage of Total
General	$ 158.0 million	15.80
Special Revenue	93.5 million	9.34
Bond	10.5 million	1.05
Capital Projects	40.4 million	4.04
Health - Employees	23.6 million	2.36
School Districts	7.4 million	0.74
Public Utilities	589.5 million	58.93
Agencies, Deposits, Misc.	50.9 million	5.09
Interest Accumulation	12.1 million	1.21
Total Monies in Transit and Adjustments	14.4 million	1.44
Total	$1,000.3 million	100.00

The City's portfolio included in the following investment instruments on September 14, 1984 (also see Chart B immediately following the introduction):

Description	Amount (Rounded)	Percentage of Total
U.S. Treasuries	$ 681.62 million	65.81
U.S. Agencies	90.00 million	8.69
Commercial Paper	190.00 million	18.35
Neg. Certificates of Deposit	54.50 million	5.26
Certificates of Deposit	19.57 million	1.89
Total	$1,035.69 million	100.00

Note that the $1,000.3 million in City Investments on August 31, 1984 are $35.39 million less than the $1,035.69 million total City investments on September 14, 1984 due to normal fluctuation in the City's total idle funds available for investing.

The City's portfolio had the following schedule of investment maturities as of September 14, 1984 (also see Chart C immediately following the introduction):

Maturity	Amount (Rounded)	Percentage of Total
Overnight	$ 190.00 million	18.35
Between One and Ninety Days	79.63 million	7.69
Between Ninety Days and One Year	34.16 million	3.30
Between Two and Four Years	155.10 million	14.97
Between Two and Four Years	157.50 million	15.21
Between Four and Five Years	70.00 million	6.76
Between Five and Nine Years	344.30 million	33.24
Over Nine Years	5.00 million	0.48
Total	$1,035.69 million	100.00

All of the City's investments are made through the City's depository bank through a safekeeping arrangement and are only executed on a cash on delivery basis. The City does not maintain brokerage accounts. This system of clearing all investment transactions through one depository bank maintains a clear accounting record of all transactions. Therefore, City monies are either in actual investments or in the City's checking account.

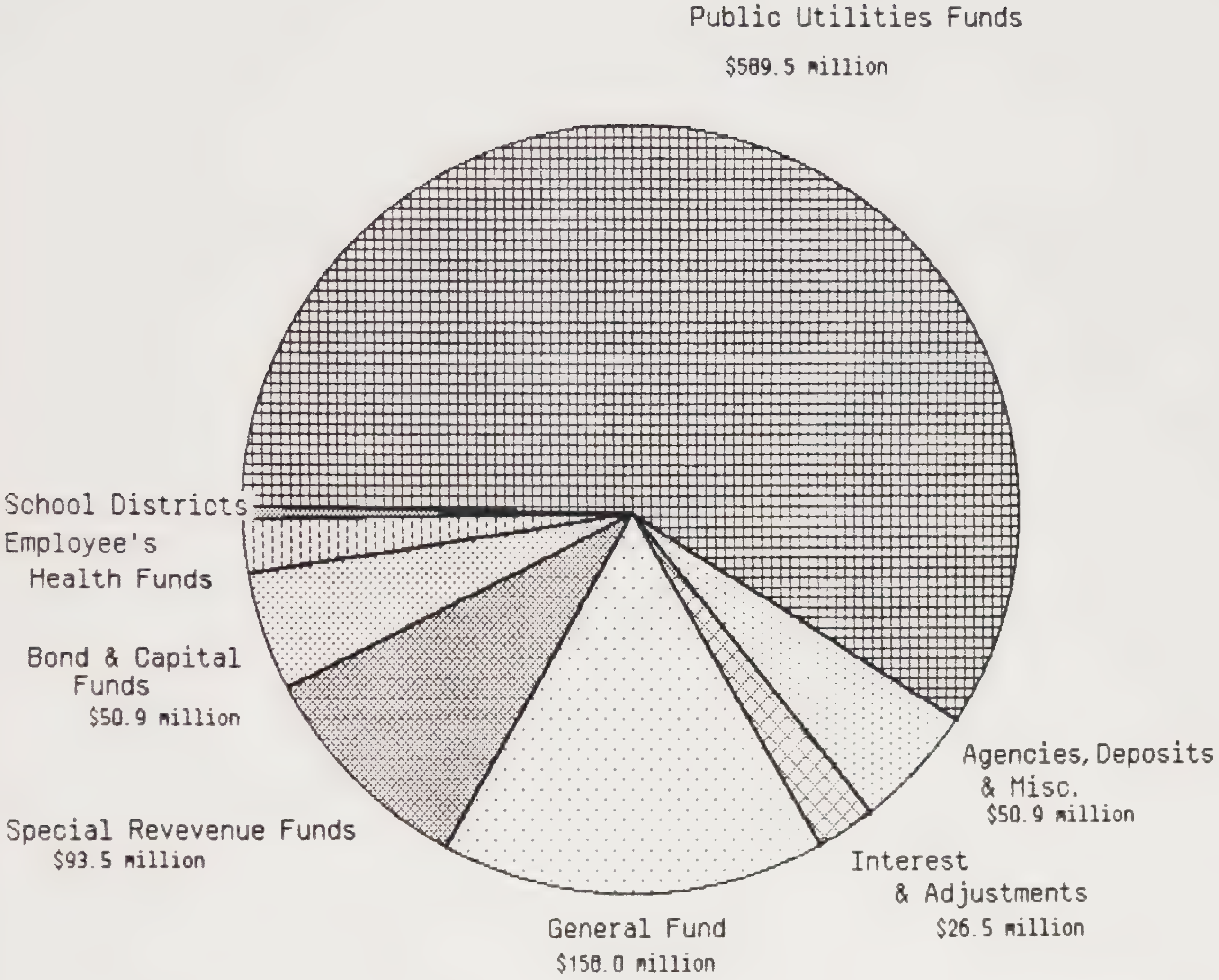
In the sections of this report that follow, we are making specific recommendations for improving: reporting practices, portfolio analysis, cash flow analysis, training for the Cash Manager to make investment analysis and transactions, and the work environment.

The implementation of these recommendations would result in an estimated increase in interest income of at least an estimated $110,000 annually. Additional annual interest income in an amount which cannot be fairly estimated might also result from implementation of our recommendations. The estimated cost to implement these recommendations is $20,000 annually plus a one-time cost of $15,000. However, even more important than the increased revenues which would accrue to the City under our recommendations, the Board of Supervisors would receive essential information about the policies, procedures, practices and results of the City's investments which the Board is now not receiving. This information should increase the likelihood of preventing investment losses.

Throughout the course of this management audit, we have received the full cooperation of the Treasurer and all her staff as well as the staffs of other City departments. They all demonstrated a willingness to consider new ideas and alternatives to existing methods of operation. Without their assistance, our work for the Board of Supervisors would have been much more difficult.

Chart A

Portfolio Fund Groups

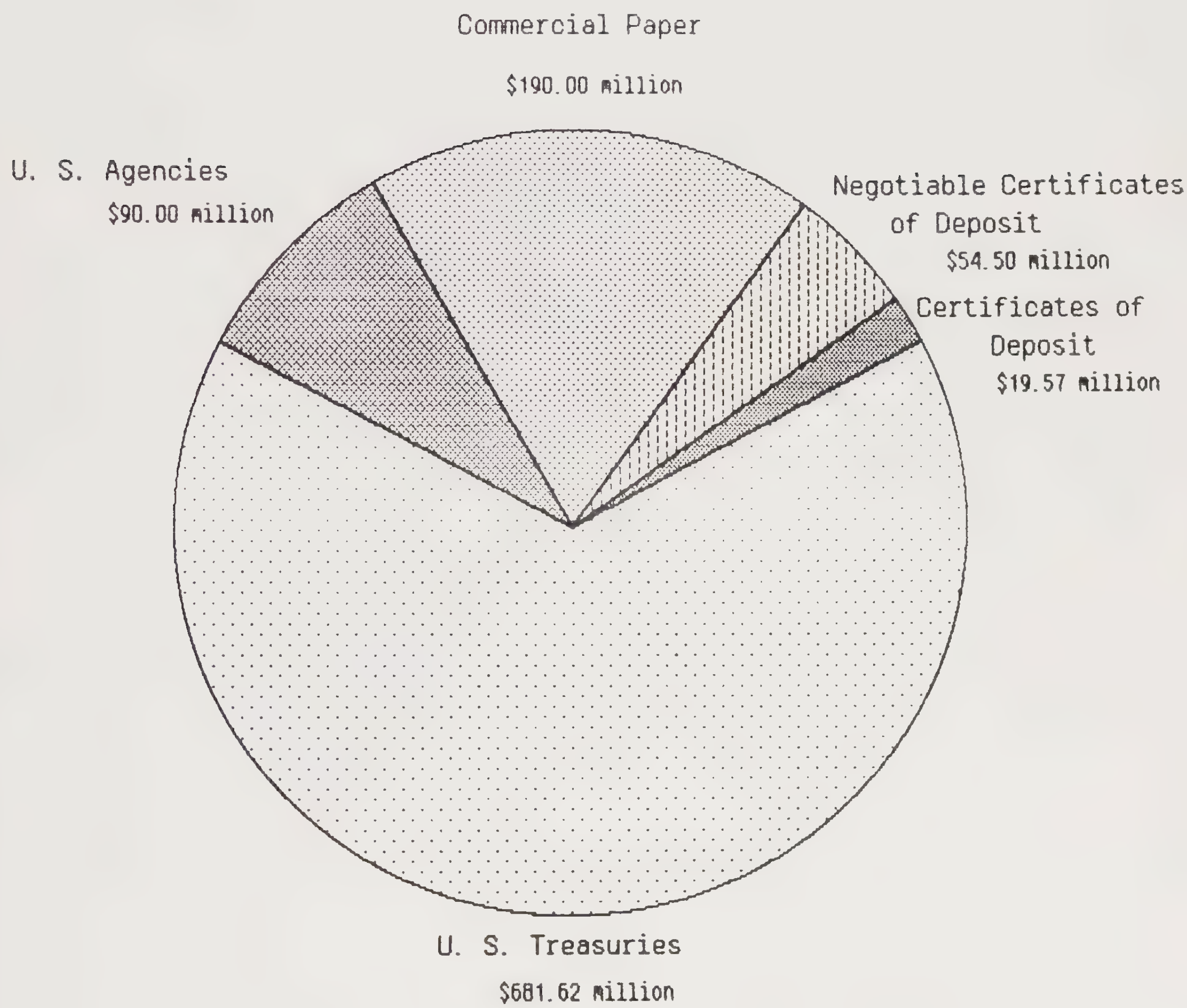


San Francisco Investment Portfolio

$1,000.3 million total
August 31, 1984

Chart B

Investment Types

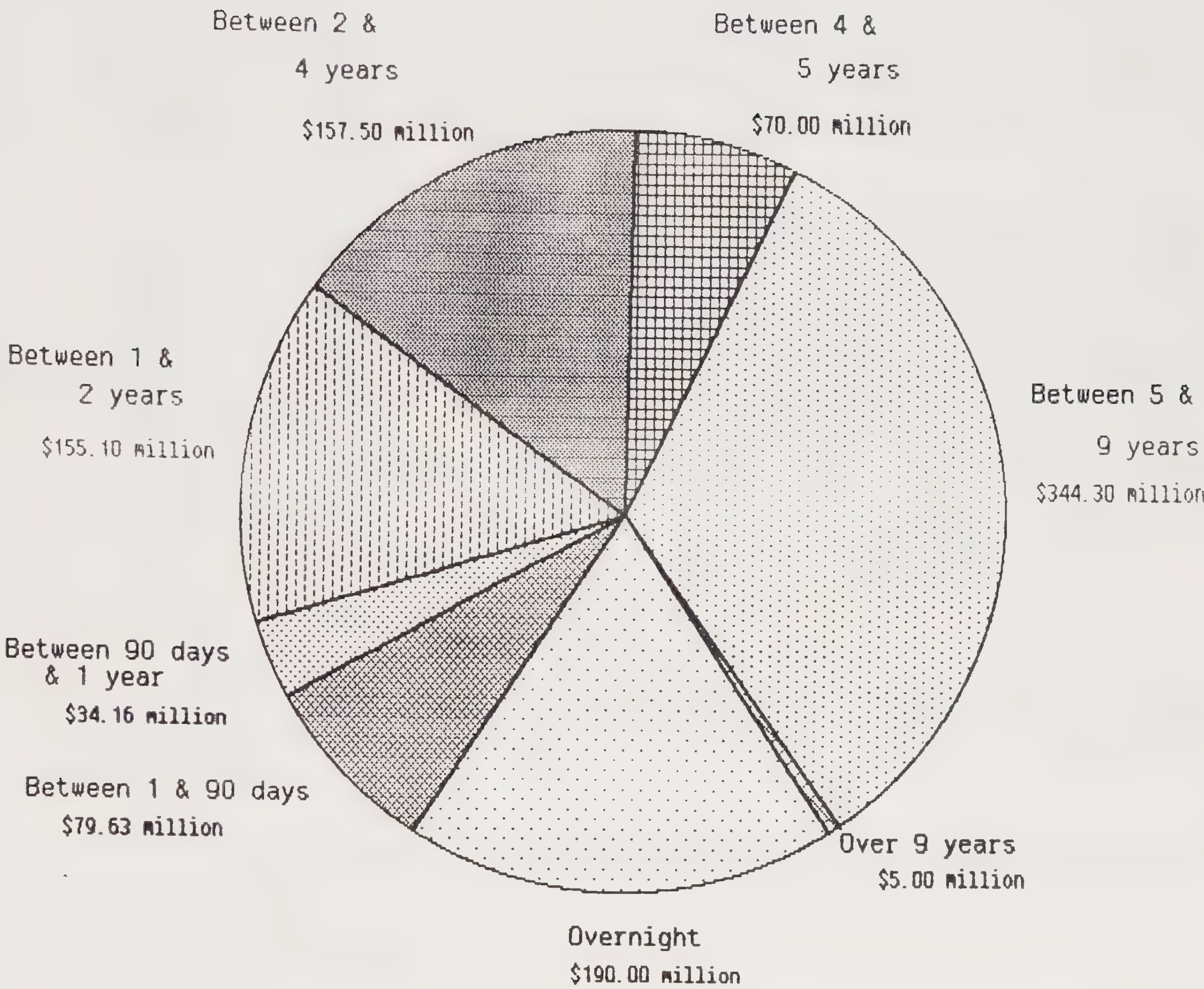


San Francisco Investment Portfolio

$1,035.69 million total
September 14, 1984

Chart C

Maturity Periods



San Francisco Investment Portfolio

$1,035.69 million total
September 14, 1984

I. INVESTMENT POLICY REVIEW AND REPORTING

THE CITY'S INVESTMENT POLICIES ARE ESTABLISHED BY THE TREASURER WITHOUT OBTAINING APPROVAL FROM THE BOARD OF SUPERVISORS. THE TREASURER DOES NOT REPORT TO THE BOARD ON INVESTMENT TRANSACTIONS AS STATED IN THE CITY'S ADMINISTRATIVE CODE. THIS RESULTS IN A LACK OF INFORMATION PROVIDED TO THE BOARD FOR THE PURPOSE OF REVIEWING THE INVESTMENT POLICIES AND ACTIVITIES OF THE TREASURER.

Under State Government Code Section 53601, the Board of Supervisors is responsible for investing the City's idle funds. In 1972, the Board of Supervisors (through Administrative Code Section 10.79-2) delegated its authority to invest City idle funds to the Treasurer. Under this Administrative Code Section, the Treasurer is required to make a monthly report of investment transactions to the Board of Supervisors. The Treasurer has not been making these required monthly reports to the Board of Supervisors. The Treasurer has been issuing monthly investment reports to the Board of Supervisors listing only the investment earnings for the month, not the record of investment transactions (purchases, sales and exchanges) as required by the City's Administrative Code.

The reporting of investment practices is important in order for superiors to be able to be informed of and respond to questionable investment situations. For example, the Arthur Young and Co. management audit of San Jose's fiscal procedures found that San Jose's $60 million investment loss could have been prevented but for a "failure at all levels of the city government" to recognize the difference between normal and speculative activities and either control or curtail speculative activities by City employees. According to this audit report, regular reports prepared by the Treasury Division to management and to the City Council "did not adequately disclose the nature or scope of the City's investment activities. As a result, there was no effective management review of the City's investment activity, and the portion of the City's activity (mainly the increasing average maturity of the investment portfolio) that could have been detected by a review of the existing reports went unnoticed."

Monthly Transaction Investment Report

The Treasurer's monthly investment transaction report could be expanded to include additional information in order for the Board of Supervisors to adequately review the nature and scope of the City's investment activities. Such additional information could include the following:

- For each investment listed in the investment transaction report (which is currently required) include the type of investment and institution, the term to maturity, the cost, and the rate of interest.

- For investments having a maturity term over one year, current and prior month's market value.

- The percentage of the portfolio invested in each type of investment instrument.

- Average market value of the investment portfolio.

- Total interest earned for the month

- Rate of return for the portfolio and the average daily balance of the portfolio.

- The rate of return from other investment indices such as the State's Local Agency Investment Fund, ninety-day U.S. Treasury bills average, a money market fund, and federal funds rates (these could be used as benchmarks for comparing the City's rate of return).

- A statement and forecast of the City's cash position including the cash balance at the end of the month reported, the estimated receipts and disbursements for the following month, the estimated cash balance at the end of the following month, the amount of investments which would come due during the month and the amount of investment which would come due after the month. (This information would indicate the availability of sufficient cash to pay the City's bills.)

- If there are investments in repurchase agreements or reverse repurchase agreements, a listing of the collateral pledged to these instruments could be included.

- A statement of the prior month's investment earnings.

- A listing of the investment earnings for the last six months.

- A comment by the Treasurer explaining changes in earnings for the portfolio.

Annual Investment Policy

The monthly investment transaction report could also contain a reference to the investments conformance to the City's investment policies. While the Treasurer has had an unwritten investment policy, in June, 1984, the Treasurer prepared what appears to be the first written investment policy for the City. This investment policy is an internal document of the Treasurer's Office. The Board of Supervisors does not approve the Treasurer's investment policy. The Board of Supervisors could amend the Administrative Code to require that the City's investment policy be approved by the Board of Supervisors. (A copy of the Treasurer's Investment Policies is included as Appendix 2).

The Treasurer's Investment Policies include the objectives of the preservation of capital, liquidity and yield, and the types of investments which are permitted to be purchased. These policies have not been submitted routinely to the Board of Supervisors for approval. These investment policies could be expanded to include more detail including the following:

- A specific measure defining the policy objective of liquidity in terms of meeting the City's cash requirements while selecting investments for periods producing the best yield.

- The policy could include a desirable percentage range of the portfolio's value for each type of investment instrument and a desirable percentage range of the number of investment transactions for each type of investment instrument.

- A statement of the expected approximate average age of the portfolio.

The Treasurer's investment policy could also set restrictions for each employee's investment authorization according to the type of instruments and dollar value of these instruments that the employee is authorized to purchase. The entire policy statement could then be sent to appropriate dealers, brokers, banks and savings and loan associations advising that this policy limits the investment authority of the specified City staff.

CONCLUSION

The Treasurer does not report monthly to the Board of Supervisors on investment transactions as required by Section 10.79-2 of the City's Administrative Code Section and does not provide the Board with other needed information pertaining to these investments.

RECOMMENDATION

We recommend that the Board of Supervisors amend the City's Administrative Code to require that the Treasurer, in addition to submitting a monthly report of all investment transactions to the Board of Supervisors, also be required to do the following:

- Submit a monthly investment transaction report on all investment transactions to the Board of Supervisors as specified on pages seven and eight.

- Submit an annual investment policy to the Board of Supervisors for approval as specified on pages eight and nine and

- Transmit the approved City investment policy to appropriate banks, savings and loan associations, dealers and brokers in order to advise these financial institutions of the City's restrictions on investments.

BENEFIT

The implementation of these recommendations would give the Board of Supervisors additional information to review performance of the City's investment portfolio and to identify and curtail unwarranted investment activities.

NOTE:

During the course of this audit, State legislation which will become effective on January 1, 1985, was adopted which would mandate many of the above recommendations as follows:

> The treasurer or chief fiscal officer shall annually render to the legislative body a statement of investment policy and a monthly report to the legislative body of the local agency showing the type of investment, institution, date of maturity, amount of deposit, market value of all securities with a maturity of more than 12 months, rates of interest, and such data as may be required by the local agency. The monthly report shall specify in detail investments made in repurchase agreements, reverse repurchase agreements, financial futures or financial options contracts. The monthly report shall state its relationship to the statement of investment policy. In the monthly report, a subsidiary ledger of investments may be used in accordance with accepted accounting practices.

The recommendations made in this report would provide more detailed information to the Board of Supervisors than are required by this new State law.

II. PORTFOLIO ANALYSIS

WHILE THE TRANSACTIONS OF THE TREASURER ARE AUDITED FOR LEGALITY AND CONFORMANCE TO GENERALLY ACCEPTED ACCOUNTING PRACTICES, THE PORTFOLIO IS NOT INDEPENDENTLY ANALYZED FOR PERFORMANCE, YIELD, MIX OF SECURITIES, AVERAGE MATURITY, OR STRATEGY. AS A RESULT, THERE IS EFFECTIVELY NO OUTSIDE, INDEPENDENT OVERSIGHT OF THE INVESTMENTS MADE BY THE TREASURER. THE BOARD OF SUPERVISORS SHOULD RECEIVE AN ANNUAL PORTFOLIO ANALYSIS REPORT FROM AN OUTSIDE, INDEPENDENT FIRM EXPERIENCED IN INVESTMENTS NOT ONLY BECAUSE SUCH AN INDEPENDENT ANALYSIS OF ALL CITY FUNCTIONS IS NECESSARY, BUT ALSO BECAUSE THE BOARD NEEDS SUCH INFORMATION TO REVIEW THE INVESTMENT POLICIES AND ACTIVITIES OF THE TREASURER.

The City's Chief Investment Officer (CIO) alone determines the amount and number of each type of investment to be purchased based on the investment's yield, liquidity, maturity, and risk. Yield is generally higher when liquidity is lower and maturity is longer. With the understanding of these relationships, the CIO determines the amount of money to invest and with the available information analyzes the current financial market situation. The more certain the resultant information is, the more able the CIO is to obtain the higher yield by selecting securities having a longer maturity and less liquidity without the risk of being forced to sell the securities prematurely at a loss.

The risk of the CIO investing in certain high risk financial instruments is limited by State law. State law specifies the investments permitted (see Appendix I) and does not permit local agencies, such as San Francisco, to invest in commodities including precious metals, futures, stocks, and other investment forms. However, while the CIO is restricted by law to purchase only relatively secure investments, substantial risks remain. The nature of these risks has been demonstrated by San Jose's recent $60 million investment loss through the excessive use of reverse repurchase agreements. In order to further limit this risk, in the prior section of this report, we recommend the institution of investment policy review and reporting controls.

In addition to the risk of a loss from the sale of an investment, the City risks opportunity loss. Opportunity loss is the loss of interest revenue as a result of not acting on the opportunity to invest in financial instruments yielding higher interest income than the interest earned in those investments which are purchased. In the extreme, the potential opportunity loss is the interest revenue which would be lost by not investing the City's idle funds at all.

The CIO attempts to balance these risks by purchasing a variety of different types of investment instruments having reasonable risk, yield, liquidity, and maturity values in response to predictions of the City's cash requirements and financial market trends. While the City's cash requirements can be predicted with some accuracy (see Section 3 on cash flow analysis), the forecasting of financial market trends is problematic. Recently, the financial market has been volatile and, therefore, difficult to anticipate. For example, bond interest rates have fluctuated more than two percentage points during the current year. The variation has been as great as five percent during the 1980 calendar year.

Notwithstanding these inherent risks and difficulties, the City's portfolio is not evaluated by qualified outside, independent portfolio analysts for appropriateness, quality or ability to meet the City's cash flow requirements. The cash balances of the Treasurer's investment accounts are audited monthly by the Controller's internal audit staff. The City's annual financial audit includes the outside auditors testing of the Treasurer's investment transaction records and procedures for conformance to law and generally accepted accounting practices.[1] The auditors have not extended their review beyond these criteria until the current 1983-84 audit in progress. A representative from the City's outside auditing firm reports that the current audit in progress is testing the CIO's compliance with the Treasurer's investment policy instituted in June 1984. However, these auditors will not include an analysis of the appropriateness of the Treasurer's investment policies or an assessment of the quality of the City's investments.

While the Board of Supervisors has delegated its investment authority to the Treasurer, the Board's oversight of the Treasurer's office would be strengthened if it contracted for annual portfolio analyses with a firm experienced in investments. The estimated annual cost for portfolio analysis is approximately $10,000. The annual portfolio analysis could include an evaluation of the alternatives for the CIO to increase the City's investment revenue while insuring the suitability and prudence of the investments, preserving the City's capital and meeting the City's cash requirements. Annual, qualified portfolio analyses would substantially improve the capacity of the Board of Supervisor's review of the City's investing activity.

Portfolio Analysis

On September 14, 1984, the par value of the portfolio was approximately $1,035,691,000 and was invested in various instruments with a variety of maturities. While the investments in the City's portfolio changes daily, the investments on this date were not abnormal and indicate the type of investments normally made and the amount of money invested in these instruments. According to the CIO, the investment instruments in the portfolio are typical for type and maturities. Our analysis follows:

- In general, the City's idle funds are invested in instruments that are sound and return interest earnings which are significantly better than those earned by the State's investment pool. For the 1983-84 fiscal year, the average rate of return for the City's portfolio was more than eleven percent while the State's Local Agency Investment fund (LAIF) earned just over ten percent. The one percentage point difference between the City and the LAIF investment earnings amounts to approximately $10 million in annual earnings for the City.

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[1] Recent audits have not reported discrepancies.

- $190 million or 18.34 percent of the portfolio is in an overnight investment. In our opinion, this would normally be an excessive amount to have invested in overnight securities. According to the CIO, the large overnight investments were made because there was an abnormality in the market's investment yields wherein overnight rates were better than the rates of longer term instruments which matured in 30 days. This abnormality in investment yields was reportedly caused by a number of government agencies which dramatically shortened the maturities of investments in their portfolios after the problems in the City of San Jose were made public. The higher demand for short term investments caused the interest rates on these securities to be reduced and overnight interest rates to be relatively higher.

- $349.3 million, or 33.73 percent of the portfolio, is in investments that will not mature in less than five years. On average, these maturities will not mature for over eight years or in 1993. Opinions vary as to how much money in a municipal portfolio should be in longer term investments. Some investment analysts believe that cities should not invest in such longer term investments because cities may be required to sell these investments before their maturity at a loss in order to meet unexpected cash requirements to pay the City's bills. Other analysts are of the opinion that only the various fund surpluses, in contrast to idle funds, should be in these investments. Still other analysts are of the opinion that once cash flow needs are met, the highest yielding investments should be purchased.

- Of the $349.3 million in long term investments, $197 million or 19.02 percent of the portfolio is in an investment which will not mature until 1993 and its current market value is approximately $7.4 million below par. This is currently not a problem because the City is able to meet cash flow requirements. This $197 million long term investment was made on February 15, 1984 prior to the time that the problems with the City of San Jose's long term investments became public. In response to the news of San Jose's losses from long term investments, the City's CIO reduced the average length of maturity of the portfolio. Reportedly, many other municipal investment officers have done the same.

- The City's portfolio is invested in securities whose value fluctuates in the market. As of September 14, 1984, the market value of the total portfolio was approximately $34 million or 3.4 percent below its cost. The problem with a portfolio that is valued below what it cost is a) if the portfolio had to be liquidated, the loss would be real; b) there are opportunity losses because the money in the portfolio cannot be invested in other higher paying investments without taking a loss; and c) the investor can try to make up for the "paper losses" by buying more securities, hoping that the market will improve (this is what happened to the City of San Jose). However, it should be noted that the City can readily meet its cash requirements at this time. Therefore, the portfolio does not have to be liquidated. Further, if interest rates were to decline, the value of the portfolio could increase significantly.

When it is desirable that investments are made that will generate higher yields, it can be expected that there will be some reasonable losses as well as significant gains. Once a decision is made to increase yield by buying securities with a long maturity, the investor must accept the commensurate risk.

CONCLUSION

There is no outside, independent analysis of the City's investment portfolio. Reports of the City's annual portfolio analysis to the Board of Supervisors would assist the Board in its oversight of the City's investment program and reduce the chances of investment losses.

RECOMMENDATION

We recommend that the Board of Supervisors annually contract with a firm experienced in investments for a portfolio analysis of the investments made by the Treasurer.

SAVINGS/BENEFIT

The estimated annual cost for a portfolio analysis of the City's investments is $10,000. The implementation of this recommendation would assist the Board of Supervisors to oversee the City's investment program and may improve investment earnings as well as reduce the risk of investment losses.

III. CASH FLOW

THE INFORMATION AVAILABLE FOR CASH FLOW ANALYSIS IS PRESENTLY INADEQUATE. AS A RESULT, THE TREASURER'S STAFF CANNOT ALWAYS PROPERLY SELECT INVESTMENT INSTRUMENTS WHICH WOULD RESULT IN THE BEST RATE OF RETURN FOR THE CITY'S PORTFOLIO. ADDITIONAL INFORMATION FOR CASH FLOW ANALYSIS WOULD IMPROVE THE TIMING OF PORTFOLIO INVESTMENTS RESULTING IN ESTIMATED INCREASED INTEREST EARNINGS OF $110,000 ANNUALLY.

Cash flow is the cash balance between money coming in and going out on a daily or weekly basis over a period of time. Cash flow analysis is a method of anticipating cash requirements for expenditures and cash availability for investment by scheduling the bills expected to be paid against the revenues expected to be received over time. The flow of revenues and expenditures often causes the treasury balance to fluctuate greatly. Because yield is generally higher when liquidity is lower and maturity is longer, with adequate cash flow information the Chief Investment Officer (CIO) can confidently invest in the highest yielding instruments while meeting the City cash requirements. Therefore, the ability to predict these fluctuations can mean the difference between a moderate or high return on monies available for investing due to the portfolio size and selection of investments.

Cash flow analysis methods can vary from the very simple to the very sophisticated. The level of sophistication depends upon how much detail is used. A cash flow analysis is often developed by using the preceding three years' actual weekly expenditures and revenues. Modifications are made as needed to deal with changes caused by inflation, the number of employees, capital purchases, utility rate changes, tax law changes, etc. Actual revenues and expenses are recorded and compared to the projected cash flow. Adjustments are then made to revise cash flow projections based upon this comparison. As experience with an organization's cash expenditure and revenue receipt cycles are gained, the cash flow projections can become reasonably accurate.

Because, normally, the longer the term of an investment the higher its yield, the City can be expected to earn a higher return if these investments are made for a longer term; such as for a week rather than overnight, or a month or more rather than for a week. Therefore, within various constraints, the City can earn the most interest income by investing at the longest term which would return the principal amount of cash just when the cash is required to pay for the City's expenses. The City's Investment Officer analyzes cash flow with the limited information available to forecast when the cash available for investing on a given day will be required to be used to pay the City's warrants. This ability to predict with reasonable accuracy the City's cash requirements allows the purchase of investments that maximize yield and mature on a schedule according to cash needs.

Presently, the Controller's Office supplies the Treasurer's Office with daily reports on warrants written. This information, together with reports of revenues received, is used to calculate the City's cash requirements for the following business day. However, advance information concerning extraordinarily large payment obligations is not made available to the Treasurer's Office. The result is that the Treasurer's Office can be unaware of some major City cash requirements and can have cash invested beyond the date it is needed to pay the City's bills and, then, be forced to sell investments prior to their term without receiving their full potential earnings. For example, in the spring of 1984, major expenditures were made to modify the Moscone Center for the Democratic Convention, start-up the cable cars, purchase new buses for the Municipal Railway, and for street repairs and paving. The expenditures were not expected by the CIO and, therefore required alteration of the Treasurer's investment strategy. This meant increasing the liquidity of the portfolio.

The major sources of cash flow information are outside of the Treasurer's Department. Normally, only the other departments are aware of the timing of extraordinary expenditure obligations which they have made. The departments do not inform the CIO of their extraordinary expenditure obligations.

The Treasurer could obtain the information needed to forecast monies available for investing by requesting that significant cash flow data be provided to the CIO. For example, all expenditures greater than one million dollars could be reported. Instructions could be issued by the Treasurer directing all departments to provide the Treasurer's Office with a monthly report projecting their cash requirements for the coming month, quarter and year. According to the CIO, such information would make an estimated average of an additional $1.1 million available to him every day to invest. For example, at a ten percent interest rate (which is a conservative rate of return in today's markets) the result would be an additional estimated $110,000 annually in interest income. In addition, having such a cash flow analysis system could improve the City's bond rating which could result in a saving on new bond issues.

The CIO also has an informal agreement with the City's Retirement Board for the timing of the withdrawal of monies from the General Fund which are to be invested in the Retirement Fund for City employees. This policy could be made formal with a written agreement between the Retirement Board and the Treasurer that delineates the conditions for the transfer of monies. This would aid cash flow analysis because the CIO would know how much money would be required for the Retirement Board at any time.

CONCLUSION

Information required to predict the City's cash flow is inadequate. Installing a formal cash flow analysis process including monthly reports by City Departments on their expected cash needs for the coming month, quarter and year would improve investment earnings because the CIO could choose investments based on better information about cash requirements.

RECOMMENDATION

We recommend that the Treasurer instruct all City Departments to provide monthly reports projecting their cash requirements so that the Treasurer can establish an improved system to analyze cash flow.

BENEFIT/SAVINGS/COSTS

The benefit of this program is improved knowledge of cash needs resulting in improved investment earnings of an estimated $110,000 annually.

IV. PERSONNEL REQUIREMENTS

WHILE THE CHIEF INVESTMENT OFFICER (CIO) REGULARLY CONSULTS WITH THE TREASURER, THE CIO IS THE ONLY EMPLOYEE IN THE TREASURER'S OFFICE WHO HAS BEEN THOROUGHLY TRAINED IN INVESTING AND MANAGING THE CITY'S PORTFOLIO. OPERATING BY HIMSELF, WITHOUT TRAINED ASSISTANCE, RESULTS IN ALL OF THE CITY'S DAY-TO-DAY INVESTMENT DECISIONS BEING MADE BY ONE PERSON. PRIOR TO HIS VACATIONS AND OTHER KNOWN ABSENCES, THE CIO TIMES INVESTMENTS IN ORDER THAT ONLY THOSE INVESTMENTS NEEDED TO MEET CASH REQUIREMENTS WILL MATURE DURING HIS ABSENCE. THIS SOMETIMES RESULTS IN INVESTMENTS WHICH DO NOT YIELD THE HIGHEST INTEREST INCOME.

The Board of Supervisors is responsible for the investment of City's idle funds and has delegated the authority for investing the City's one billion dollar portfolio to the Treasurer via Administrative Code Section 10.79-2. The Treasurer has assigned the task of investing these funds to the Chief Investment Office (CIO) who presently is the only person in the Treasurer's Office who has been thoroughly trained to invest and manage the City's portfolio.

The Investment Division has four employees: The CIO, Cash Manager, Clerk Typist and Senior Account Clerk. The CIO is responsible for making the investment decisions and transactions. The Cash Manager's position was vacant for approximately seven months. The current Cash Manager was hired in August of this year and is learning the duties of the position and is also installing a program on the division's new personal computer to improve the analysis of cash flow information. The CIO's two clerks are responsible for record keeping and correspondence.

Problems

Large public and private businesses generally have sufficient employees so that there is overlap in the expertise, experience and responsibility of the investment staff. In this way, a qualified employee is available to assume duties when an employee is absent or leaves the company's employment. Further, the overlap of staff qualifications allows for professional investment analysis among employees so that investment decisions are more likely to be well thought through.

While the CIO regularly consults with the Treasurer, the Investment Division does not have such an overlap of employee qualifications. When the CIO is absent, no one is available who has been thoroughly trained in temporarily managing the portfolio. There are two persons in the Treasurer's Office who can and have made investments in overnight investments but they are not fully knowledgeable in the City's overall investment procedures especially the requirements involving longer term investments. Therefore, when the CIO knows he is going to be absent for an extended period (e.g.: vacation), he "times" the investments based on cash flow needs. This sometimes results in investments which do not yield the highest interest income. The CIO also makes certain that a large amount of money is available for overnight investment. Then, one of

the other employees in the Treasurer's Office is assigned to invest the money in overnight securities during his absence. The amount of these securities varies, depending upon the City's cash needs. If, during these absences, the investments could be handled normally, the City would have better control of the portfolio and the investments would then result in an undetermined amount of higher interest earnings.

Other than the Treasurer, there is no one staff person who is available to discuss and consult with the CIO relating to investment, economic, business and other issues which can affect the City's portfolio. While the CIO routinely goes outside the City for advice, he should have some in-house assistance from a staff person who is also thoroughly trained in investments. Operating alone, without trained assistance, could possibly result in making inferior investment decisions. One of the major problems in San Jose was City staff continuing to make investments in long term bonds hoping that the market would turn around after they had lost money. There apparently was a lack of communication among staff to determine how best to improve the City's investment situation.

Cash Manager Training

The City's investment program could be continually managed during the absences of the CIO and the CIO could be given ongoing investment assistance if the cash manager position were upgraded.

The Cash Manager could be trained to invest the City's portfolio in a professional manner. This training could be provided through the County Treasurer's Organization, seminars and schools. Given the additional responsibilities of the Cash Manager position, Civil Service should consider upgrading the position to Assistant Investment Officer/Cash Manager. The additional cost of this change would be determined by Civil Service depending upon the duties to be required but should be less than $10,000 annually.

CONCLUSION

Although the Chief Investment Officer regularly consults with the Treasurer, the Chief Investment Officer is operating without professional staff assistance in making investment decisions and transactions. This burden on him is unnecessary and it can be reduced by training other staff or hiring another qualified employee.

RECOMMENDATION

We recommend that the Cash Manager receive training in investment analysis and decision making and that the Treasurer should request the Civil Service Commission to reclassify the Cash Manager position to an Assistant Investment Officer/Cash Manager position.

COST/BENEFIT

The costs for training the Cash Manager are minimal. A reclassification of this position to Assistant Investment Officer/Cash Manager would result in additional estimated costs of $10,000 annually. The resulting benefits would be improved investment divisions and increased investment earnings of an undetermined amount.

V. ENVIRONMENTAL HAZARDS

THE PERSONNEL IN THE INVESTMENT DIVISION OF THE TREASURER'S OFFICE WORK IN AN AREA THAT OFTEN HAS A VERY HIGH TEMPERATURE. AS A RESULT, WORKING CONDITIONS ARE INADEQUATE AND COULD RESULT IN EQUIPMENT FAILURE AND PERSONNEL ILLNESS. ADDITIONALLY, THERE IS INADEQUATE SPACE AND ELECTRICAL SERVICE FOR THE INVESTMENT DIVISION.

Good working conditions are important for employee health and morale. These same conditions are also important for efficient equipment operation. The Investment Division of the Treasurer's office is located in a small office on the mezzanine in the Treasurer's area above the cashiers. In addition to the four employees of the division, there is equipment which generates a substantial amount of heat. The average daily temperature is above 80 degrees Fahrenheit and often is much warmer. The staff has used fans in the past to attempt to circulate and cool the air but because there is no outside ventilation. This action has been ineffective as stale air from the surrounding office areas replaces the air moved out of their office.

The Investment Division recently installed an personal computer and related hardware in addition to their Moneymax and Tellerate terminals and other office equipment. All this equipment generates heat when operating, adding to the temperature problem in the office. At the same time, this equipment is temperature sensitive and the high temperature in the office could lead to equipment failure and costly repairs.

The exposure to high temperatures is unhealthy and unnecessary. The present working conditions could lead to fatigue and result in illness, morale problems and poor decision making. A better work environment could mean improvements in these areas.

A representative from the Health Department investigated the problem at the request of the Budget Analyst. The results of the investigation were that the temperature on the main floor was 72 degrees Fahrenheit and in the investment office, the temperature was 79.5 degrees Fahrenheit due to poor movement of air. The recommendation was that a mechanical ventilation system be installed, controlled by the employees of the Investment Division, that would circulate fresh and cool air into the room.

Based on a preliminary review by a representative from the Architects Division of the Department of Public Works, we estimate that the cost to install a unit air conditioner to be approximately $3,000. Ductwork could be installed to exhaust the air to the outside of City Hall, if desired.

Three of the four Investment Division employees are crowded into a small room. However, there is a room next to theirs which could be used if a common wall were removed. It could be cooled by the same unit air conditioner. The present office is also lacking in electrical service. More space should be made available by removing the common wall between the two rooms and installing adequate electrical service. The cost of this remodeling is estimated to be $12,000.

CONCLUSION

The present working environment in the Investment Division is inadequate because the area is isolated from a fresh air source. Conditions would be improved by the installation of a unit air conditioner supplying fresh air to the Investment Division's room. In addition, the present office is crowded and electrical service is inadequate.

RECOMMENDATION

We recommend that a unit air conditioner be installed in the Investment Division's workspace and that increased space and improved electrical service be provided for this division.

BENEFIT/COST

The employees would benefit from a better work environment at an estimated one-time cost of $3,000 to install a unit air conditioner and minimal annual operating costs. A reduction in the temperature would also reduce the likelihood of a computer failure. Further expanded space and additional electrical service would also significantly improve employee working conditions. The cost to remodel the work space is estimated to be $12,000.

City and County of San Francisco

Office of the Treasurer

MARY I. CALLANAN
TREASURER

GIN L. SO
CHIEF ASSISTANT TREASURER

INVESTMENT DIVISION
558-4688

October 15, 1984

Harvey M. Rose, Budget Analyst
San Francisco Board of Supervisors
City Hall
San Francisco, Calif. 94102

Dear Mr. Rose:

In responding to your review of the investment policies, procedures and practices of the Treasurer's office, I would first like to commend you and your staff on the courtesy and professionalism exhibited in approaching this rather complex area of financial management.

I am cognizant of the fact that, although investment policies have been in effect through internal oral instructions and frequent review of reports, these policies were not committed to written form until earlier this year. Copies of the policy statement were sent to the Board of Supervisors as requested.

The form of report sent to the Board of Supervisors in the past has indeed been lacking in detail. The information to be contained in reports to the Board which is suggested by your review is, and has been, available in our office, and will be provided to the Board on a regular basis as stated in the City's Administrative Code.

I would emphasize that, as stated in your report, San Francisco does not use the investment techniques which led to the losses experienced by San Jose. I believe the portfolio distribution displayed in your report reflects the high quality of our investments.

Your concern with the inadequacy of information on the City's cash flow has likewise been of concern to me for some time. My staff and I have been working with the Controller's staff and our computer consultants in an effort to formulate effective reporting procedures. We shall continue these efforts and inform you of our progress.

Upgrading of our investment staff has been an on-going project in cooperation with the Civil Service Commission staff, and will be further pursued as you suggest.

(415) 558-4575 110 City Hall San Francisco, California 94102

Harvey M. Rose, Budget Analyst
San Francisco Board of Supervisors

October 15, 1984

Finally, we agree that there are environmental hazards, as well as certain security problems, which must be addressed. The Board recently approved funds for a work order to the Department of Public Works to provide plans and an estimate of costs to remedy these problems. We will look forward to your support of the capital funds appropriation which will be required when costs are known.

Once again, let me thank you for your courtesy and concern, and assure you that we will provide you and the Board with timely statistics and progress reports in the other areas discussed.

Yours very truly,

Mary I. Callanan

Mary I. Callanan
Treasurer

13. Priority of Special Assessment Liens. §§ 53930–53937
14. Pleasure Riding Tax. §§ 53940–53947

ARTICLE 1

Investment of Surplus

§ 53600. "Local agency"

As used in this article, "local agency" means county, city, public district, or any public or municipal corporation.

Added Stats 1949 ch 81 § 1.

City and County of San Francisco (1908) 162 F. 441, 89 C.C.A. 327, certiorari denied 30 S.Ct. 405, 215 U.S. 604, 54 L.Ed. 345.

Deferred compensation plan funds held by local agencies may not be invested in life insurance policies, but may be invested in other types of investments as authorized by §§ 53601, 53602, 53600. 58 Ops. Atty.Gen. 129, 2-20-75.

§ 53601. Circumstances authorizing investments; authorized investments

The legislative body of a local agency having money in a sinking fund of, or surplus money in, its treasury not required for the immediate necessities of the local agency may invest such portion of the money as it deems wise or expedient in:

(a) Bonds issued by it, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by it or by a department, board, agency, or authority thereof.

(b) United States Treasury notes, bonds, bills, or certificates of indebtedness, or those for which the faith and credit of the United States are pledged for the payment of principal and interest.

(c) Registered state warrants or treasury notes or bonds of this state, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the state or by a department, board, agency, or authority thereof.

(d) Bonds, notes, warrants, or other evidences of indebtedness of any local agency within this state, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the local agency, or by a department, board, agency, or authority thereof.

(e) Obligations issued by banks for cooperatives, federal land banks, federal intermediate credit banks, federal home loan banks, the Federal Home Loan Bank Board, the Tennessee Valley Authority, or in obligations, participations, or other instruments of or issued by, or fully guaranteed as to principal and interest by, the Federal National Mortgage Association; or in guaranteed portions of Small Business Administration notes; or in obligations, participations, or other instruments of or issued by a federal agency or a United States government-sponsored enterprise.

(f) Bills of exchange or time drafts drawn on and accepted by a commercial bank, otherwise known as bankers acceptances, which are eligible for purchase by the Federal Reserve System. Purchases of bankers acceptances may not exceed 270 days maturity or 30 percent of the agency's surplus money which may be invested pursuant to this section.

The provisions of this subdivision shall not preclude a municipal utility district from investing any surplus money in its treasury in any manner authorized by the Municipal Utility District Act.

(g) Commercial paper of "prime" quality of the highest ranking or of the highest letter and numerical rating as provided for by Moody's Investors Service, Inc., or Standard and Poor's Corporation. Eligible paper is further limited to issuing corporations that are organized and operating within the United States and having total assets in excess of five hundred million dollars ($500,000,000) and having an "A" or higher rating for the issuer's debentures, other than commercial paper, as provided for by Moody's Investors Service, Inc., or Standard and Poor's Corporation. Purchases of eligible commercial paper may not exceed 180 days maturity nor represent more than 10 percent of the outstanding paper of an issuing corporation. Purchases of commercial paper may not exceed 15 percent of the agency's surplus money which may be invested pursuant to this section.

(h) Negotiable certificates of deposits issued by a nationally or state-chartered bank or a state or federal savings and loan association. Purchases of negotiable certificates of deposit may not exceed 30 percent of the agency's surplus money which may be invested pursuant to this section. For purposes of this section, negotiable certificates of deposits do not come within the provisions of Article 2 (commencing with Section 53630) of Chapter 4 of Part 1 of Division 2 of Title 5.

(i) Investments in repurchase agreements or reverse repurchase agreements of any securities authorized by this section. For purposes of this section, the term "repurchase agreement" means a purchase of securities by the local agency pursuant to an agreement by which the seller will repurchase such securities on or before a specified date and for a specified amount.

For purposes of this section, the term "reverse repurchase agreement" means a sale of securities by the local agency pursuant to an agreement by which the local agency will repurchase such securities on or before a specified date and for a specified amount.

(Added by Stats.1949, c. 81, p. 289, § 1. Amended by Stats.1951, c. 1643, p. 3697, § 1; Stats.1953, c. 537, p. 1798, § 2; Stats.1954, Ex.Sess., c. 10, p. 257, § 1; Stats.1967, c. 275, p. 1433, § 1; Stats.1967, c. 1316, p. 3140, § 2; Stats.1974, c. 1354, p. 2938, § 1; Stats.1975, c. 649, p. 1406, § 1; Stats.1977, c. 1138, p. 3657, § 1.5; Stats.1978, c. 65, p. 181, § 1; Stats.1979, c. 158, p. 354, § 1; Stats.1979, c. 275, p. 942, § 2.5; Stats.1981, c. 185, § 2; Stats. 1982, c. 508, § 2.)

Historical Note

As added, this section read:

"The legislative body of a local agency having money in a sinking fund of, or surplus money in, its treasury not required for the immediate necessities of the local agency may invest such portion of the money as it deems wise or expedient in:

"(a) Bonds issued by it.

"(b) United States Treasury notes or bonds or those for which the faith and credit of the United States are pledged for the payment of principal and interest.

"(c) Treasury notes or bonds of this State or of any local agency within this State.

"(d) Registered state warrants."

The 1951 amendment rewrote subd. (a) to read as it now appears and, in subd. (c), following "within this State" added "including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the State or any local agency, or by a department, board, agency or authority thereof."

The 1953 amendment added, in subd. (b), bills or certificates of indebtedness as authorized investments.

The 1954 amendment rewrote subds. (c) and (d) to read as follows:

"(c) Registered state warrants or treasury notes or bonds of this State including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the State or by a department, board, agency or authority thereof.

"(d) Bonds, notes, warrants or other evidences of indebtedness of any local agency within this State, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled or operated by the local agency, or by a department, board, agency or authority thereof."

The 1967 amendments added subd. (e).

The 1974 amendment added subd. (f).

The 1975 amendment, in subd. (e), following "Federal National Mortgage Association;", substituted "or in obligations, participations, * * * United States government—sponsored enterprise" for

"or in participation certificates evidencing beneficial interests in obligations, or in the right to receive interest and principal collections therefrom, which obligations have been subjected by one or more government agencies to a trust or trusts for which any executive department, agency, or instrumentality of the United States (or the head thereof) has been named to act as trustee."; in subd. (f), in the first sentence of the first paragraph, substituted "purchase by the Federal Reserve System" for "use as collateral by member banks for borrowing from the Federal Reserve bank", and, in the second sentence, substituted "270" for "90"; and deleted the second paragraph of subd. (f), which read:

"The provisions of subdivision (f) of this section shall only be applicable to cities and special districts having treasury balances including cash and investments as of the end of the prior fiscal year in the excess of eight million dollars ($8,000,000) or counties having treasury balances including cash and investments as of the end of the prior fiscal year in excess of thirty million dollars ($30,000,000)."

The 1977 amendment, in subd. (f), substituted "30 percent" for "15 percent".

The 1978 amendment, in the first paragraph of subd. (f), following "270 days maturity", substituted "or" for "nor exceed", and in the second paragraph, substituted "this subdivision" for "subdivision (f) of this section"; and added subds. (g) and (h).

The 1979 amendments, at the end of subds. (g) and (h), substituted "100,000" for "250,000"; near the beginning of subd. (h), substituted "issued by" for "purchased from"; and added subd. (i).

Amendment of this section by § 2 of Stats.1979, c. 275, p. 940, failed to become operative under the provisions of § 4 of Stats.1979, c. 275.

The 1981 amendment inserted in subd. (e) guaranteed portions of small business administration notes and decreased the population in the second paragraph of subd. (h) from 100,000 to 50,000.

The 1982 amendment deleted the second paragraph of subd. (g), which had read:

"No investment in securities described in this subdivision shall be made by a local agency having a population of less than 100,000"; and deleted the second paragraph of subd. (h), which had read:

"No investment in securities described in this subdivision shall be made by a local agency having a population of less than 50,000."

Derivation: Stats.1913, c. 73, p. 76, § 1; Stats.1927, c. 27, p. 28, § 1; Stats.1933, c. 217, p. 716, § 1; Stats.1937, c. 903, p. 2489, § 1; Stats.1941, c. 17, p. 430, § 1; Stats.1943, c. 227, p. 1128, § 2; Stats. 1943, c. 571, p. 2140, § 2.

§ 53633. Determination of amount to be deposited as inactive and active deposits

The Treasurer shall determine the amounts of money to be deposited as inactive and active deposits, except as otherwise provided in Section 53679.

Added Stats 1949 ch 81 § 1; Amended Stats 1953 ch 670 § 1.

Prior Law: Based on Stats 1933 ch 189 § 3 p 643, as amended by Stats 1935 ch 710 § 2 p 1918, Stats 1947 ch 973 § 2 p 2242.

Amendments:

1953 Amendment: Added ", except as otherwise provided in Section 53679".

Collateral References:

Cal Jur 2d Municipal Corporations § 269.

§ 53634. Transfer of inactive deposits to active deposits

The treasurer may call in money from inactive deposits and place it in active deposits as current demands require. When there is money in his possession for which there is no demand as inactive deposits, he may place it as active deposits.

Added Stats 1949 ch 81 § 1.

Prior Law: Based on Stats 1933 ch 189 § 3 p 643, as amended by Stats 1935 ch 710 § 2 p 1918, Stats 1947 ch 973 § 2 p 2242.

Collateral References:

Cal Jur 2d Municipal Corporations § 269.

McKinney's Cal Dig Banks §§ 80 et seq., Counties §§ 120 et seq., Municipal Corporations §§ 161 et seq., Public Funds §§ 3 et seq., Public Officers §§ 58 et seq

Am Jur 2d Banks §§ 336, 355, 368, Municipal Corporations, Counties, and Other Political Subdivisions §§ 277, 288, 579, 582, 585–587, Public Funds §§ 9–12, 76, Public Officers and Employees §§ 322–325, 328.

§ 53635. Deposit of money of local agency

So far as possible, all money belonging to, or in the custody of, a local agency, including money paid to the treasurer or other official to pay the principal, interest, or penalties of bonds, shall be deposited for safekeeping in state or national banks in the state selected by the treasurer or other official having the legal custody of the money, or may be invested in:

(a) Bonds or interest-bearing notes or obligations of the United States, or those for which the faith and credit of the United States are pledged for the payment of principal and interest.

(b) Bonds of this state, or those for which the faith and credit of this state are pledged for the payment of principal and interest.

(c) Bonds of any county, city, metropolitan water district, municipal utility district, or school district of this state.

(d) Bonds, consolidated bonds, collateral trust debentures, consolidated debentures, or other obligations issued by federal land banks or federal intermediate credit banks established under the Federal Farm Loan Act, as amended, in debentures and consolidated debentures issued by the Central Bank for Cooperatives and banks for cooperatives established under the Farm Credit Act of 1933, as amended. in bonds or debentures of the Federal Home Loan Bank Board established under the Federal Home Loan Bank Act [12 USCS §§ 1421–1449], in stock, bonds, debentures and other obligations of the Federal National Mortgage Association established under the National Housing Act as amended [12 USCS §§ 1701 et seq.], and in the bonds of any federal home loan bank established under said act.

Added Stats 1949 ch 81 § 1; Amended Stats 1967 ch 1026 § 1.

Prior Law: Based on Stats 1933 ch 189 § 1 1st sent p 642, as amended by Stats 1935 ch 710 § 1 p 1917, Stats 1937 ch 605 § 1 p 1698, Stats 1939 ch 551 § 1 p 1950, Stats 1941 ch 342 § 1 p 1591, Stats 1943 ch 125 § 1 p 825, Stats 1945 ch 486 § 1 p 985, Stats 1947 ch 973 § 1 p 2241

Amendments:

1967 Amendment: (1) Amended the introductory paragraph by (a) substituting "state" for "State" before "selected"; and (b) adding ", or may be invested in"; and (2) added subds (a) through (d).

Note—The Federal Farm Loan Act and the Farm Credit Act of 1933, referred to in subd (d) of this section, and formerly appearing as 12 USCS §§ 641 et seq. and 12 USCS §§ 1131 et seq., respectively, have been repealed.

Collateral References:

Cal Jur 2d Banks § 125, Municipal Corporations § 269.

McKinney's Cal Dig Banks §§ 80 et seq., Counties §§ 120 et seq., Municipal Corporations §§ 161 et seq., Public Funds §§ 3 et seq., Public Officers §§ 58 et seq.

Am Jur 2d Banks §§ 336, 355, 368, Municipal Corporations, Counties, and Other Political Subdivisions §§ 277, 288, 579, 582, 585–587, Public Funds §§ 9–12, 76, Public Officers and Employees §§ 322–325, 328.

Attorney General's Opinions:

30 Ops Atty Gen 54 (school district's deposit of proceeds of bond sale, pending their use for payment of construction contracts).

NOTES OF DECISIONS

The Depositary Acts of 1927 and 1933 followed the administrative practice of depositing in state and national banks funds in the county treasury, regardless of the source from which said funds were derived. Pomona City School Dist. v Payne (1935) 9 CA2d 510, 50 P2d 822.

The Depositary Act of 1933 authorizing placement of public funds in state or national banks was passed primarily to secure the safety of such public moneys. Metropolitan Water Dist. v Adams (1948) 32 C2d 620, 197 P2d 543.

The county treasurer is authorized to deposit at interest, not only funds coming into his custody as an official of the county and as ex-officio treasurer of school or other districts, but also funds, which belong to a public or municipal corporation, but enter his hands via an eminent domain proceeding from the court as its treasurer. Metropolitan Water Dist. v Adams (1948) 32 C2d 620, 197 P2d 543.

bonds issued pursuant to this section, shall be canceled by order of the legislative body and shall not be issued.

This section shall become operative * * * January 1, 1986.

(Amended by Stats.1983, c. 293, p. ----, § 6, operative Jan. 1, 1986.)

For text of section operative until Jan. 1, 1986, see § 53541, ante.

CHAPTER 4. FINANCIAL AFFAIRS

ARTICLE 1. INVESTMENT OF SURPLUS

§ 53601. Circumstances authorizing investments; authorized investments

The legislative body of a local agency having money in a sinking fund of, or surplus money in, its treasury not required for the immediate necessities of the local agency may invest such portion of the money as it deems wise or expedient in:

(a) Bonds issued by it, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by it or by a department, board, agency, or authority thereof.

(b) United States Treasury notes, bonds, bills, or certificates of indebtedness, or those for which the faith and credit of the United States are pledged for the payment of principal and interest.

(c) Registered state warrants or treasury notes or bonds of this state, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the state or by a department, board, agency, or authority thereof.

(d) Bonds, notes, warrants, or other evidences of indebtedness of any local agency within this state, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the local agency, or by a department, board, agency, or authority thereof.

(e) Obligations issued by banks for cooperatives, federal land banks, federal intermediate credit banks, federal home loan banks, the Federal Home Loan Bank Board, the Tennessee Valley Authority, or in obligations, participations, or other instruments of or issued by, or fully guaranteed as to principal and interest by, the Federal National Mortgage Association; or in guaranteed portions of Small Business Administration notes; or in obligations, participations, or other instruments of or issued by a federal agency or a United States government-sponsored enterprise

(f) Bills of exchange or time drafts drawn on and accepted by a commercial bank, otherwise known as bankers acceptances, which are eligible for purchase by the Federal Reserve System. Purchases of bankers acceptances may not exceed 270 days maturity or 40 percent of the agency's surplus money which may be invested pursuant to this section. However, no more than 30 percent of the agency's surplus funds may be invested in the bankers acceptances of any one commercial bank pursuant to this section.

The provisions of this subdivision shall not preclude a municipal utility district from investing any surplus money in its treasury in any manner authorized by the Municipal Utility District Act.

(g) Commercial paper of "prime" quality of the highest ranking or of the highest letter and numerical rating as provided for by Moody's Investors Service, Inc., or Standard and Poor's Corporation. Eligible paper is further limited to issuing corporations that are organized and operating within the United States and having total assets in excess of five hundred million dollars ($500,000,000) and having an "A" or higher rating for the issuer's debentures, other than commercial paper, as provided for by Moody's Investors Service, Inc., or Standard and Poor's Corporation. Purchases of eligible commercial paper may not exceed 180 days maturity nor represent more than 10 percent of the outstanding paper of an issuing corporation. Purchases of commercial paper may not exceed 15

Asterisks * * * indicate deletions by amendment

percent of the agency's surplus money which may be invested pursuant to this section. An additional 15 percent, or a total of 30 percent of the agency's surplus money, may be invested pursuant to this subdivision. The additional 15 percent may be so invested only if the dollar-weighted average maturity of the entire amount does not exceed 31 days. "Dollar-weighted average maturity" means the sum of the amount of each outstanding commercial paper investment multiplied by the number of days to maturity, divided by the total amount of outstanding commercial paper.

(h) Negotiable certificates of deposits issued by a nationally or state-chartered bank or a state or federal savings and loan association or by a state-licensed branch of a foreign bank. Purchases of negotiable certificates of deposit may not exceed 30 percent of the agency's surplus money which may be invested pursuant to this section. For purposes of this section, negotiable certificates of deposits do not come within the provisions of Article 2 (commencing with Section 53630) of Chapter 4 of Part 1 of Division 2 of Title 5, except that the amount so invested shall be subject to the limitations of Section 53638.

(i) Investments in repurchase agreements or reverse repurchase agreements of any securities authorized by this section. For purposes of this section, the term "repurchase agreement" means a purchase of securities by the local agency pursuant to an agreement by which the seller will repurchase such securities on or before a specified date, or on demand of either party, and for a specified amount. Such securities, for purpose of repurchase under this subdivision, shall mean securities of the same issuer, description, issue date, and maturity.

For purposes of this section, the term "reverse repurchase agreement" means a sale of securities by the local agency pursuant to an agreement by which the local agency will repurchase such securities on or before a specified date and for a specified amount.

(Amended by Stats.1983, c. 550, p. ---, § 1; Stats.1983, c. 567, p. ——, § 1.5.)

1983 Legislation.

Amendment of this section by § 1.5 of Stats.1983, c. 550, p. ——, failed to become operative under the provisions of § 3 of that Act.

Amendment of this section by § 1 of Stats.1983, c. 567, p. ——, failed to become operative under the provisions of § 3 of that Act.

§ 53601.1. Investment in financial futures or financial option contracts

The authority of a local agency to invest funds pursuant to Section 53601 includes, in addition thereto, authority to invest in financial futures or financial option contracts in any of the investment categories enumerated in that section.

(Added by Stats.1983, c. 534, p. ——, § 3.)

Library References

Counties ⟹ 154½.
C.J.S. Counties § 229.

ARTICLE 2. DEPOSIT OF FUNDS

Sec.
53632.5. Classes of security for deposits [New].

§ 53632. Classes of deposits

There are three classes of deposits:

(a) Inactive deposits.

(b) Active deposits.

(c) Interest-bearing active deposits.

(Amended by Stats.1983, c. 105, p. ——, § 1.5.)

§ 53632.5. Classes of security for deposits

There are two classes of security for deposits:

(a) Securities described in subdivision (m) of Section 53651.

Underline indicates changes or additions by amendment

(b) Securities enumerated in Section 53651, except for those described in subdivision (m) of that section.

(Added by Stats.1983, c. 105, p. ——, § 2.)

§ 53633. Determination of amounts to be deposited in each class

The treasurer shall determine the amounts of money to be deposited as inactive, active, and interest-bearing active deposits, except as otherwise provided in Section 53679.

(Amended by Stats.1983, c. 105, p. ——, § 3.)

§ 53635. Funds of local agency; deposit or investment

As far as possible, all money belonging to, or in the custody of, a local agency, including money paid to the treasurer or other official to pay the principal, interest, or penalties of bonds, shall be deposited for safekeeping in state or national banks or state or federal savings and loan associations in the state selected by the treasurer or other official having the legal custody of the money, or may be invested in the following unless otherwise directed by the legislative body pursuant to Section 53601:

(a) Bonds issued by it, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by it or by a department, board, agency, or authority thereof.

(b) United States Treasury notes, bonds, bills, or certificates of indebtedness, or those for which the faith and credit of the United States are pledged for the payment of principal and interest.

(c) Registered state warrants or treasury notes or bonds of this state, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the state or by a department, board, agency, or authority thereof.

(d) Bonds, notes, warrants, or other evidences of indebtedness of any local agency within this state, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the local agency, or by a department, board, agency, or authority thereof.

(e) Obligations issued by banks for cooperatives, federal land banks, federal intermediate credit banks, federal home loan banks, the Federal Home Loan Bank, the Tennessee Valley Authority, or in obligations, participations, or other instruments of or issued by, or fully guaranteed as to principal and interest by, the Federal National Mortgage Association; or in guaranteed portions of Small Business Administration notes; or in obligations, participations, or other instruments of or issued by a federal agency or a United States government-sponsored enterprise.

(f) Bills of exchange or time drafts drawn on and accepted by a commercial bank, otherwise known as bankers acceptances, which are eligible for purchase by the Federal Reserve System. Purchases of bankers acceptances may not exceed 270 days maturity or 40 percent of the agency's surplus funds which may be invested pursuant to this section. However, no more than 30 percent of the agency's surplus funds may be invested in the bankers acceptances of any one commercial bank pursuant to this section.

The provisions of this subdivision shall not preclude a municipal utility district from investing any surplus money in its treasury in any manner authorized by the Municipal Utility District Act.

(g) Commercial paper of "prime" quality of the highest ranking or of the highest letter and numerical rating as provided for by Moody's Investors Service, Inc., or Standard and Poor's Corporation. Eligible paper is further limited to issuing corporations that are organized and operating within the United States and having total assets in excess of five hundred million dollars ($500,000,000) and having an "A" or higher rating for the issuer's debentures, other than commercial paper, as provided for by Moody's Investors Service, Inc., or Standard and Poor's Corporation. Purchases of eligible commercial paper may not exceed 180 days maturity nor represent more than 10 percent of the outstanding paper of an issuing corporation. Purchases of commercial paper may not exceed 15 percent of the agency's surplus money which may be invested pursuant to this section. An additional 15 percent, or a total of 30 percent of the agency's money or money in its custody, may be invested pursuant to this subdivision. The additional 15 percent may be so invested only if the dollar-weighted average maturity of the entire amount does not exceed 31 days. "Dollar-weighted average maturity" means the sum of the amount of each outstanding commercial paper investment multiplied by the number of days to maturity, divided by the total amount of outstanding commercial paper.

(h) Negotiable certificates of deposits issued by a nationally or state-chartered bank or a state or federal savings and loan association or by a state-licensed branch of a foreign bank. Purchases of

negotiable certificates of deposit may not exceed 30 percent of the agency's surplus money which may be invested pursuant to this section. For purposes of this section, negotiable certificates of deposits do not come within the provisions of Article 2 (commencing with Section 53630) of Chapter 4 of Part 1 of Division 2 of Title 5, except that the amount so invested shall be subject to the limitations of Section 53638.

(i) Investments in repurchase agreements or reverse repurchase agreements of any securities authorized by this section. For purposes of this section, the term "repurchase agreement" means a purchase of securities by the local agency pursuant to an agreement by which the seller will repurchase such securities on or before a specified date, or on demand of either party, and for a specified amount. Such securities, for purpose of repurchase under this subdivision, shall mean securities of the same issuer, description, issue date, and maturity.

For purposes of this section, the term "reverse repurchase agreement" means a sale of securities by the local agency pursuant to an agreement by which the local agency will repurchase such securities on or before a specified date and for a specified amount.

Investment in a reverse purchase agreement shall be made only upon prior approval of the legislative body of the local agency.

(Amended by Stats.1983, c. 550, p. ——, § 2; Stats.1983, c. 567, p. ——, § 2.5.)

1983 Legislation.

Amendment of this section by § 2.5 of Stats.1983, c. 550, p. ——, failed to become operative under the provisions of § 4 of that Act.

Amendment of this section by § 2 of Stats.1983, c. 567, p. ——, failed to become operative under the provisions of § 4 of that Act.

§ 53639. Expense of transporting money

Except as otherwise provided in Section 53682, the depositary shall bear the expenses of transportation of money to and from the depositary.

(Amended by Stats.1983, c. 105, p. ——, § 4.)

§ 53640. Checks, drafts, and other exchange

Except as otherwise provided in Section 53682, the depositary shall handle, collect, and pay all checks, drafts, and other exchange without cost to the local agency.

(Amended by Stats.1983, c. 105, p. ——, § 5.)

§ 53643. Deposit by treasurer

The treasurer may deposit any part of the money * * * as agreed upon between the treasurer and the depositary.

(Amended by Stats.1983, c. 105, p. ——, § 6.)

§ 53644. Withdrawals on demand; penalties; notice

If an agreement is not made:

(a) Active deposits and interest thereon are subject to withdrawal upon the demand of the treasurer or other authorized official, subject to any penalties which may be prescribed by federal law or regulation.

(b) Inactive deposits are subject to notice of at least thirty days before withdrawal.

(Amended by Stats.1983, c. 105, p. ——, § 7.)

§ 53646. Statement by treasurer showing accrued interest

The treasurer shall render to the depositary and to the auditor, controller, secretary, or corresponding officer of the local agency, a statement showing the amount of accrued interest for each depositary for the preceding quarter if so required by the legislative body of the local agency.

(Amended by Stats.1983, c. 105, p. ——, § 8.)

Underline indicates changes or additions by amendment

City and County of San Francisco

Office of the Treasurer

MARY I. CALLANAN
TREASURER

GIN L. SO
CHIEF ASSISTANT TREASURER

INVESTMENT DIVISION
558-4688

June 25, 1984

Mr. John L. Taylor
Clerk of the Board of Supervisors
City and County of San Francisco
Room 235 - City Hall
San Francisco, California 94102

Dear Mr. Taylor:

The following information is submitted in response to your request of June 6, 1984, concerning the City's investment program.

Our investment policy guidelines are attached as Appendix I. You will note that they conform in terms of the type of instruments in which we invest with California Government Code Section 53635 which is attached as Appendix II.

In addition, I have attached a list of investments showing a breakdown by type of security as of June 25, 1984 (Appendix III). I also wish to note that a review of the past two months' statistics indicates that we have maintained an average daily balance in cash, or cash equivalents, of over $100 million, approximately 10% of our total investment portfolio.

In response to the inquiry as to whether the City's investment records reflect present market value rather than cost, it should be noted that since municipal governments are not taxable entities it is standard procedure to maintain investment records on a cost basis. Market value (mark to market) is determined in connection with our annual audit. The portfolio is scheduled to be appraised on a mark to market basis as of June 30, 1984. Virtually any investment in fixed income securities is subject to price fluctuation based on the day-to-day, if not hour-to-hour, movement of interest rates.

The City does not maintain a margin account, nor do we speculate. Our investments are predicated on our cash flow projections, and investments are made on the basis of preserving the capital which we manage by continuing to invest in creditworthy and highly liquid (marketable) instruments.

(415) 558-4575 110 City Hall San Francisco, California 94102

Insofar as San Jose's investments are concerned, it is my understanding that its well reported problems stem from a pyramid of borrowings associated with a money market instrument referred to as "Reverse Repurchase Agreements." The investment officials, reportedly, utilized the City's investments as collateral to borrow funds which were used to reinvest in additional securities. As interest rates soared over the most recent period the chain had to unravel as calls for additional collateral to be pledged against the borrowings were made to reduce the price exposure to those holding the City's securities. San Jose was over leveraged with a nonexistent investment revenue base. Its borrowing costs rose faster than the income on the investments.

The City and County of San Francisco does not have a Reverse Repurchase Agreement Obligation outstanding. In fact, we are one of the very few political subdivisions in the State that, as a matter of practice, has chosen not to engage in these transactions. Let it be understood that, prudently managed, such instruments are a useful tool in one's investment kit and are a necessary ingredient in assisting the Federal Reserve Bank manage the monetary policy of the United States.

I welcome the Board's inquiry and would be pleased at any time to answer any further questions. It is extremely disconcerting to witness the plight of our neighbor to the south, but please be assured there is no similar problem with our investment holdings.

Very truly yours,

Mary I. Callanan

Mary I. Callanan
Treasurer

MIC:jj

Enclosures

cc: Supervisor Quentin L. Kopp

OFFICE OF THE TREASURER

CITY AND COUNTY OF SAN FRANCISCO

Investment Policies

The following guidelines shall be incorporated within our investment strategies for fiscal year 1983/84 and thereafter unless and until they are modified by the Treasurer.

Our basic objectives, in order of priority, are:

1) Preservation of Capital

2) Liquidity

3) Yield - Generation of a favorable return on investments without undue compromise of the first two objectives.

Types of permissible investment vehicles are generally defined in California State Government Code Section 53635* however, the following further refinements should be observed.

(*See synopsis attached)

Public Time Deposits (Term)

Deposits will be made only in approved financial institutions having at least one branch within the bounderies of the City and County of San Francisco.

All time deposits shall be negotiated to yield a minimum of .125% higher than equal maturity Treasuries.

Restrict exposure to $100,000 for all Savings and Loan Institutions because of the absence of realistic improvement in lending practices ($100,000 fully secured by F.S.L.I.C.)

We will not use money broker deposits.

Commercial bank deposits will also be made on a competitive basis with exposure based on financial statements and related information gathered on each individual bank. We will not accept mortgage backed collateral but will only accept 110% collateralization authorized in Government Code Sec. 53651 (a) through (l).

Negotiable Certificates of Deposit

We shall limit purchases of Negotiable Certificates of Deposit to the five largest California commercial banks and we will not make purchases on the secondary market. The spread to Treasuries at purchase shall exceed 60 basis points.

APPENDIX I

City & County of S. F. - Treasurer's Investment Policies - page 2

Securities - Money Market Instruments

All securities shall be purchased and sold in a competitive environment and restricted to the primary ~~reporting~~ government securities dealers.

U. S. Treasury Instruments (highest quality investment available)

T-Bills - No restrictions

T-Notes - Not restricted but cash flow analysis should be considered when purchasing longer maturities.

T-Bonds - Subject to cash flow analysis and restricted to a maximum of 10% of the total portfolio.

Federal Agencies (de facto backing of the Federal Government)

Cash flow analysis should be considered when purchasing longer maturities. A limit of 10% of total portfolio shallbe imposed on all purchases of specific agencies with maturities in excess of 1 year.

FHLB (Fed. Home Loan Bank)- maximum 10% of total portfolio
FFCB (Fed. Farm Credit Bank) " " " " "
FNMA "Fannie Mae" (Fed. Natl. Mort. Asso.)- max. 10% of portfolio
SLMA "Sallie Mae" (Student Loan Marketing Asso)max." " "

At the present time we will not purchase"Ginnie Mae's" (Govt. National Mortgage Asso.) or SBA's (Small Business Administration) because of accounting procedures and investment community perceptions.

Bankers Acceptances

We shall utilize this instrument to satisfy specific cash management needs up to maturities of 120 days.

Commercial Paper

We shall purchase only domestic C/P with maturities not to exceed 45 days, issuer must be rated in the highest grade by at least two of the three major rating agencies (Moodys, S & P or Fitch)

Repurchase Agreements

We shall selectively utilize this investment vehicle with terms not to exceed four days, secured solely by government securities and only with our present safe-keeping bank. We will accept the rate concession, because money-market collateral and broker transactions pay higher but the risks of a "Lombard-Wall" situation continues to exist.

Reverse-Repurchase Agreements

This procedure shall be limited to rare occasions when the cost effectiveness dictates execution. A reverse-repo term is not to exceed one month; the amount of the agreement will not exceed $25MM; and only a single agreement can be in effect at one time.

Reverse-repurchase agreements will be restricted solely to our present safe-keeping bank because of the proper audit controls and to eliminate dealer risk.

Financial Futures or Options Contracts

These investment vehicles shall not be used during fiscal year 1983-84 or thereafter unless specifically authorized in writing by amendment to these policies.

Synopsis of Calif. State Govt. Code Sec. 53635
Pursuant to Sec. 53601

1) Public Time Deposits

2) Our own bonds

3) U. S. Treasuries (Bills, Notes, Bonds)

4) State registered warrants, notes or bonds

5) Local Agencies of the State (bonds, notes, etc.)

6) Agencies
   A) banks for cooperatives
   B) federal land banks
   C) federal intermediate credit banks
   D) Federal Home Loan Bank (FHLB)
   E) Tennessee Valley Authority (TVA)
   F) Federal National Mortgage Asso. (FNMA "Fannie Mae")
   G) Small Business Administration (SBA)
   H) Other federal agencies or U.S. Govt. sponsored enterprise

7) Bankers Acceptances eligible for purchase by Fed. Reserve System
   A) Not to exceed 270 days maturity
   B) " " " 40% of portfolio
   C) " " " 30% of portfolio in any one bank

8) Commercial Paper
   A) Prime quality - Highest rating by Moody's or S & P
   B) Corporations organized & operating in U.S. with Assets in excess of $500,000,000
   C) Not to exceed 180 days maturity
   D) " " " 10% of Corporations outstanding paper
   E) " " " 15% of portfolio or
   30% " " if dollar weighted aver. maturity does not exceed 31 days.

9) Negotiable Certificates of Deposits
   Issued by National or State Chartered Bank,
   " " " " Savings & Loan Association, or
   State licensed branch of Foreign Bank
   May not exceed 30% of portfolio

10) Repurchase or Reverse Repurchase Agreements

Sec. 53601.1 Extends authority to invest in financial futures or financial option contracts in any of the investment categories enumerated above.

§ 53633. Determination of amount to be deposited as inactive and active deposits

The treasurer shall determine the amounts of money to be deposited as inactive, active, and interest-bearing active deposits, except as otherwise provided in Section 53679.

Amended Stats 1983 ch 105 § 3.

Amendments:

1983 Amendment: Substituted ", active, and interest-bearing" for "and" after "as inactive".

Cal Jur 3d Municipalities § 347.

§ 53634. Transfer of inactive deposits to active deposits

Cal Jur 3d Municipalities § 347.

§ 53635. Deposit and investment of funds of local agencies

As far as possible, all money belonging to, or in the custody of, a local agency, including money paid to the treasurer or other official to pay the principal, interest, or penalties of bonds, shall be deposited for safekeeping in state or national banks or state or federal savings and loan associations in the state selected by the treasurer or other official having the legal custody of the money, or may be invested in the following unless otherwise directed by the legislative body pursuant to Section 53601:

(a) Bonds issued by it, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by it or by a department, board, agency, or authority thereof.

(b) United States Treasury notes, bonds, bills, or certificates of indebtedness, or those for which the faith and credit of the United States are pledged for the payment of principal and interest.

(c) Registered state warrants or treasury notes or bonds of this state, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the state or by a department, board, agency, or authority thereof.

(d) Bonds, notes, warrants, or other evidences of indebtedness of any local agency within this state, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the local agency, or by a department, board, agency, or authority thereof.

(e) Obligations issued by banks for cooperatives, federal land banks, federal intermediate credit banks, federal home loan banks, the Federal Home Loan Bank, the Tennessee Valley Authority, or in obligations, participations, or other instruments of or issued by, or fully guaranteed as to principal and interest by, the Federal National Mortgage Association; or in guaranteed portions of Small Business Administration notes; or in obligations, participations, or other instruments of or issued by a federal agency or a United States government-sponsored enterprise.

(f) Bills of exchange or time drafts drawn on and accepted by a commercial bank, otherwise known as bankers acceptances, which are eligible for purchase by the Federal Reserve System. Purchases of bankers acceptances may not exceed 270 days maturity or 40 percent of the agency's surplus funds which may be invested pursuant to this section. However, no more than 30 percent of the agency's surplus funds may be invested in the bankers acceptances of any one commercial bank pursuant to this section.

The provisions of this subdivision shall not preclude a municipal utility district from investing any surplus money in its treasury in any manner authorized by the Municipal Utility District Act.

(g) Commercial paper of "prime" quality of the highest ranking or of the highest letter and numerical rating as provided for by Moody's Investors Service, Inc., or Standard and Poor's Corporation. Eligible paper is further limited to issuing corporations that are organized and operating within the United States and having total assets in excess of five hundred million dollars ($500,000,000) and having an "A" or higher rating for the issuer's debentures, other than commercial paper, as provided for by Moody's Investors Service, Inc., or Standard and Poor's Corporation. Purchases of eligible commercial paper may not exceed 180 days maturity nor represent more than 10 percent of the outstanding paper of an issuing corporation. Purchases of commercial paper may not exceed 15 percent of the agency's surplus money which may be invested pursuant to this section. An additional 15 percent, or a total of 30 percent of the agency's money or money in its custody, may be invested pursuant to this subdivision. The additional 15 percent may be so invested only if the dollar-weighted average maturity of the entire amount does not exceed 31 days. "Dollar-weighted average maturity" means the sum of the amount of each outstanding commercial paper investment multiplied by the number of days to maturity, divided by the total amount of outstanding commercial paper.

(h) Negotiable certificates of deposits issued by a nationally or state-chartered bank or a state or federal savings and loan association or by a state-licensed branch of a foreign bank. Purchases of negotiable certificates of deposit may not exceed 30 percent of the agency's surplus money which may be invested pursuant to this section. For purposes of this section, negotiable certificates of deposits do not come within the provisions of Article 2 (commencing with Section 53630) of Chapter 4 of Part 1 of Division 2 of Title 5, except that the amount so invested shall be subject to the limitations of Section 53638.

(i) Investments in repurchase agreements or reverse repurchase agreements of any securities authorized by this section. For purposes of this section, the term "repurchase agreement" means a purchase of securities by the local agency pursuant to an agreement by which the seller will repurchase such securities on or before a specified date, or on demand of either party, and for a specified amount. Such securities, for purpose of repurchase under this subdivision, shall mean securities of the same issue, description, issue date, and maturity.

For purposes of this section, the term "reverse repurchase agreement" means a sale of securities by a local agency pursuant to an agreement by which the local agency will repurchase such securities on or before a specified date and for a specified amount.

Investment in a reverse purchase agreement shall be made only upon prior approval of the legislat[ive] body of the local agency.

Amended Stats 1975 ch 643 § 1; Stats 1976 ch 349 § 18, effective July 9, 1976; Stats 1977 ch 1138 § 2; Stats 1978 ch [...] § 2; Stats 1979 ch 158 § 2, ch 275 § 3.5; Stats 1981 ch 185 § 3; Stats 1982 ch 508 § 3; Stats 1983 ch 550 § 2, ch [...] § 2.5

Amendments:

1975 Amendment: Amended the section to read as at present, except for the following amendments.

1976 Amendment: (1) Added "or state or federal savings and loan association" after "national banks" in introductory clause; and (2) deleted "Board" after "Bank" in subd (e).

1977 Amendment: (1) Added "the following unless otherwise directed by the legislative body pursuant to Section 536[01]" in the introductory clause; and (2) substituted "30" for "15" in subd (f).

1978 Amendment: In addition to changes in punctuation the amendment (1) substituted "this subdivision" [for] "subdivision (f) of this section" in the second paragraph of subd (f); and (2) added subds (g) and (h).

1979 Amendment: (1) Substituted "100,000" for "250,000" wherever it appears in the second paragraphs of subds [(g)] and (h); (2) substituted "issued by" for "purchased from" after "certificates of deposits" near the beginning of s[ubd] (h); and (3) added subd (i).

1981 Amendment: (1) Added "or in guaranteed portions of Small Business Administration notes;" in subd (e); and substituted "50,000" for "100,000" at the end of subd (h).

1982 Amendment: (1) Deleted the former second paragraph of subd (g) which read: "No investment in securit[ies] described in this subdivision shall be made by a local agency having a population of than 100,000."; and (2) amen[ded] subd (h) by (a) substituting "30 percent" for "15 percent"; and (b) deleting the former second paragraph which re[ad:] "No investment in securities described in this subdivision shall be made by a local agency having a population of l[ess] than 50,000."

1983 Amendment: (1) Amended the first paragraph of subd (f) by (a) substituting "40 percent" for "30 percent" in second sentence; and (b) adding the third sentence; (2) added the fifth, sixth, and seventh sentences of subd (g); amended subd (h) by adding (a) "or by a state-licensed branch of a foreign bank" at the end of the first sentence; [and] (b) ", except that the amount so invested shall be subject to the limitations of Section 53638" at the end of subdivision; and (4) amended subd (i) by adding (a) ", or on demand of either party," in the second sentence; and the third sentence. (As amended by Stats 1983, ch 567, compared to the section as it read prior to 1983. This sect[ion] was also amended by an earlier chapter, ch 550. See Gov C § 9605.)

Municipal Utility District Act: Pub U C §§ 11501 et seq.

Cal Jur 3d Banks and Other Financial Institutions § 118, Municipalities § 347.

§ 53635.5. Foreign banks

For purposes of being a depository of moneys belonging to or being in the custody of a local agency, [the] phrases "state or national bank located in this state", "state or national bank", "state or national bank [in] this state" and "state or national banks in the state" include a foreign bank licensed under Article [3] (commencing with Section 1750) of Chapter 13.5 of Division 1 of the Financial Code to maintain [a] branch office in this state or authorized under federal law to maintain a federal branch in this state.

Added Stats 1976 ch 505 § 2; Amended Stats 1981 ch 67 § 26, effective June 16, 1981.

Amendments:

1981 Amendment: Substituted "bank licensed under Article 3 (commencing with Section 1750) of Chapter 13.5 [of] Division 1 of the Financial Code to maintain a branch office in this state or authorized under Federal law to main[tain] a federal branch in this state" for "banking corporation authorized, pursuant to the provisions of subdivision (c) [of] Section 1756 of the Financial Code, to transact in this state the business of accepting deposits".

45 Cal Jur 3d Municipalities § 347.

§ 53637. Depository to be selected from banks agreeing to pay highest rate of interest

The money shall be deposited in any depositary selected from those banks and those savings and lo[an] associations agreeing to pay the highest rate of interest.

Amended Stats 1976 ch 349 § 20, effective July 9, 1976; Stats 1978 ch 489 § 1.

Amendments:

1976 Amendment: Added "and those savings and loan associations".

1978 Amendment: Deleted ", not less than one-half of 1 percent a year" at the end of the section.

Cal Jur 3d Banks and Other Financial Institutions § 120, Municipalities § 347.

§ 53638. Maximum deposit

(a) The deposit shall not exceed the total of the paid-up capital and surplus of any depositary bank. F[or] the purposes of this subdivision, paid-up capital shall be deemed to include capital notes and debenture[s].

(b) The deposit shall not exceed the total of the net worth of any depositary savings and lo[an] association, except that deposits not exceeding a total of five hundred thousand dollars ($500,000) may [be] made to a savings and loan association without regard to the net worth of that depositary, if su[ch] deposits are insured or secured as required by law.

Amended Stats 1976 ch 349 § 20.5, effective July 9, 1976; Stats 1982 ch 1224 § 1.

Amendments:

1976 Amendment: Added "bank or the total of the net worth, of any depositary savings and loan association" at the [end] of the first sentence.

C I T Y / C O U N T Y O F S A N F R A N C I S C O
M R . D A N I E L D A L Y 4 1 5 - 5 5 8 - 4 6 8 8
PORTFOLIO STATISTICS
FROM:06/25/84 TO:06/25/84 RUN ON:06/25/84

ALL FUNDS

DESCRIPTION	AVERAGE BALANCE	PERIOD END YIELD
TIME DEPOSITS	22,598,465.51	10.37
TREASURY BILLS	9,963,709.91	10.12
TREASURY NOTES	632,339,608.43	11.00
TREASURY BONDS	45,270,906.64	12.19
FICB	0.00	0.00
FEDERAL HOME LOAN BANK	46,930,574.31	12.26
FEDERAL NATIONAL MORTGAGE ASSN.	17,097,251.38	10.78
FEDERAL LAND BANK	0.00	0.00
GOVERNMENT NAT'L. MORTGAGE ASSN.	0.00	0.00
FEDERAL FARM CREDIT BANK	24,054,222.22	11.67
OTHER AGENCIES	5,000,000.00	10.50
FNMA DISCOUNT NOTES	0.00	0.00
FARM CREDIT DISCOUNT NOTES	0.00	0.00
FEDERAL HOME LOAN DISC NOTES	0.00	0.00
BANKERS ACCEPTANCE-DOMESTIC	0.00	0.00
BANKERS ACCEPTANCE-FOREIGN	0.00	0.00
REPURCHASE AGREEMENTS	0.00	0.00
PASSBOOKS	0.00	0.00
COMMERCIAL PAPER DISC	0.00	0.00
COMMERCIAL PAPER INT BEARING	144,000,000.00	11.13
NEGOTIABLE C.D.'S	54,702,516.40	10.87
TOTAL	1,001,957,254.80	11.11

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APPENDIX III

GLOSSARY

Cash Flow

The net of cash receipts and disbursements over time.

Financial Market

A term used to denote the place where investments are made. Primary money markets involve the first sale of an investment instrument where the investor buys directly from the issuer. The purchase of bank securities and Treasury Bill auctions are examples of primary money markets. Secondary markets allow security buyers and sellers to transfer title to an instrument without affecting the obligations of the issuer. The purchase of Treasury Bills from a bank is an instance of a secondary market.

Idle Funds

Money that is available in the City treasury, but not needed for day-to-day expense obligations. Idle funds are created by the time-lag between the receipt of revenues and cash disbursements. Note that cash flow is a measure of idle funds available over time.

Investment Instruments

Certificate of Deposit

A bank deposit evidenced by a negotiable or non-negotiable instrument which provides on its face that the amount of such deposit is payable to the bearer or to any specified person on a certain date specified in the instrument, at the expiration of a certain specified time, or upon notice in writing.

Commercial Paper

Business promissory notes, with a stated date of payment, which are usually sold at a discount and are backed by the general credit of a company. Commercial paper is usually issued in maturities of 30 days to 9 months. It carries normally 1/4 to 1/2 percent higher yield than Treasury Bills of comparable maturity.

Demand Deposit

A noninterest-bearing depository account from which withdrawals may be made as desired, e.g. a checking account. The Federal Reserve Act requires that no interest be paid on demand deposits: they are often called nonactive accounts from an investment viewpoint.

Municipal Bond

A written, interest bearing certificate of debt with the promise to pay on a specific day, usually paying interest semi-annually. Generally bonds are of three types: (1) general obligation bonds which are secured by the pledge of the issuer's full faith and credit, usually including unlimited taxing power; (2) improvement bonds which can be secured by the full faith and credit of the district covered by the issue or representing a lien on a specific piece of property which is defined in the bond indenture; and (3) revenue bonds secured by revenues derived by the operations of a specific public enterprise, such as toll bridges, toll roads or utility systems. Revenue bonds have no claims on the borrower's taxable resources unless otherwise specified in the bond indenture.

Negotiable Certificates of Deposit

"Negotiable CDs" offer the advantage of high interest bank deposits for a generally shorter term of investment than for regular CDs. Also, both the maturities and the interest rate are negotiable. Maturities start at 30 days but can be drawn up for several years, with the exact period determined between the bank and the locality. Denominations, however, are high, starting at $100,000. The primary market exists constantly, while a good secondary market provides generally high liquidity.

Repurchase Agreement

A repurchase agreement is a short-term investment device wherein the City with money to invest, usually for a short period of time (1 to 7 days), purchases a security, i.e., a Treasury Bill, from the bank in return for the bank's agreement to "repurchase" the security on a specified date for a specified amount. The principal is guaranteed and the return fixed under such an agreement.

Reverse Repurchase Agreement

A reverse repurchase agreement (RPA) is a device wherein the City sells a security from its portfolio and agrees to buy it back on a specified date for a specified amount. This is, in effect, a means for the City to borrow funds which are normally used to purchase other investments offering a higher rate of return than the cost of the RPA loan.

Time Deposits

A bank deposit drawing interest at intervals, e.g., a savings account, having a restrictive level of withdrawal activity, and legally requiring an advance notice of withdrawal of funds. This last characteristics is normally enforced only on a large deposits.

Treasury Obligations (includes Treasury Bills, Notes and Bonds)

These securities represent obligations backed by the full faith and credit of the Federal Government. The Treasury Bill is sold at a discount to maturity representing the return to the investor whereas the Treasury Note is interest bearing payable semi-annually. The Treasury Bill represents short-term financing, 91 days to 1 year, and the Treasury Notes represent longer term investments of 1 to 7 years. Treasury Bonds represent long-term financing of 5 years or more.

U.S. Agency Securities

Interest bearing obligations issued by federal agencies which are not backed by the full faith and credit of the government but are considered virtually risk free in the sense that the government supervises and regulates the issuers. Normally maturities range from 6 month to 15 years. Examples are the Federal National Mortgage Association "Fanny Mae" and the Bank for Cooperative Notes.

Liquidity

A measure of the ability to convert a security into cash promptly with minimum risk of loss of principal.

Maturity

The date upon which the bond becomes due and payable by the issuer at face (par) value.

Moneymax and Tellerate Services

These are investment information services which provide investors with current information about interest rates for various securities, yield curves, etc.

Negotiable

A term used to designate a security, the title to which is transferable to another, e.g., the sale of a treasury bill in a secondary market.

Par (Face) Value

The value of a security is expressed on its face without consideration to any premium or discount. It also signifies the dollar value on which the interest rate is calculated.

Portfolio

The itemization of all investments currently held by the agency.

Premium

The amount by which price exceeds par value of a security (e.g., if a bond of $1000 par value sells for $1100, it sells at $100 or 10% premium). Also, the amount over par payable to the holder of a callable bond by the issuer, if and when the bond is called.

Principal

The face or par value of an instrument, exclusive of accrued interest.

Rate of Return

The yield obtainable on a security based on its purchase price, sale price and interest income over the time period it is held.

Revenue

Money that flows into a local government. Revenue may be recurring, that which is received by a local government on a consistent and periodic basis, e.g., sales tax revenue, and nonrecurring, that which is received only on specific occasions, e.g., federal grant.

Risk

The probability of loss. Risk involves the possibility of losing some or all of the initial principal amount of the investment security or accrued interest.

Warrant

A warrant is a promise to pay a sum of money to the payee at some future date upon presentation to the issuer. Warrants are presented to a clearing bank for payment and the clearing bank then presents the warrants to the governmental unit and receives payments. Warrants are used in place of checks by local governments in order to better control the date of payment of obligations and increase cash availability. Warrants are different from checks in that the latter is an order to the bank to pay on demand to the authorized payee from a demand deposit account.

Yield

The true rate of return on a security investment. Exactly defined, it is the interest rate which will discount the maturity value and any accumulated interest payments received from a security to equal its purchase price. A less exact, but easier to use definition is: The sum of changes in the price of the security plus interest earned as a percent of the purchase price on an annual basis.